REVIEW CREDIT AVAILABILITY, DELINQUENT LOAN SERVICING, AND LENDING POLICIES OF THE FARMERS HOME ADMINISTRATION; AND IMPLEMENTATION OF CREDIT PROVISIONS OF THE 1985 FARM BILL

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT

OF THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

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REVIEW CREDIT AVAILABILITY, DELINQUENT LOAN SERVICING, AND LENDING POLICIES OF THE FARMERS HOME ADMINISTRATION; AND IMPLEMENTATION OF CREDIT PROVISIONS OF THE 1985 FARM BILL

THURSDAY, FEBRUARY 6, 1986

House of Representatives,
Subcommittee on Conservation,
Credit, and Rural Development,
Committee on Agriculture,
Washington, DC.

The subcommittee met, pursuant to call, at 1 p.m., in room 1302, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives Glickman, Daschle, Stenholm, Tallon, Evans of Illinois, Thomas, Stallings, Coleman, Morrison, Gunderson, and Evans of Iowa.

Also present: Representative E (Kika) de la Garza, chairman of the committee; Representatives Rose, Bedell, and Olin, members of the committee.

Staff present: Phillip L. Fraas, counsel; John E. Hogan, minority counsel; Glenda L. Temple, clerk; Charles Rawls, Bernard Brenner, Robert A. Cashdollar, James W. Johnson, Jr., Fred Clark, and Susan Adkins.

OPENING STATEMENT OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. Jones of Tennessee. The Subcommittee on Conservation, Credit, and Rural Development will come to order.

This afternoon's hearing is the first official meeting of the subcommittee since the second session of the 99th Congress convened. It should be of little surprise to anybody that our first meeting would involve the issue of agricultural credit. As we approach the spring planting season in the Farm Belt, I am sure that every member representing a rural district is being bombarded with questions and case work concerning agricultural credit availability.

Today I hope we can focus on how the Farmers Home Administration intends to deal with what appears to be an increasingly serious problem for thousands of farmers this year as their lenders are refusing to extend operating credit, are unable to refinance their debt, and in many cases, have decided to foreclose their operations.

In the last several weeks the Farmers Home Administration has announced its intentions to implement a new set of loan servicing policies for its delinquent borrowers. A number of different versions of FmHA's new loan servicing policies have been announced, and today would be a good time to settle on exactly what the agency plans to do with its delinquent borrowers and when it plans to do it.

Also, the Farmers Home Administration recently published a proposed rule in the Federal Register which would allow the Administrator to restrict loans for the purpose of producing a commodity which is in surplus. I am greatly concerned about the broad discretion this rule would grant the Administrator, and the potential for using this authority to completely shut down all FmHA lending since practically every agricultural commodity produced in this country is in surplus at this time.

This afternoon we also hope to explore the implications of the Gramm-Rudman Balanced Budget and Emergency Deficit Control Act on the Farmers Home Administration. We need to know exactly how the Department intends to absorb the budget cuts in the Farmers Home Administration for fiscal year 1986 and fiscal year 1987 which have been announced in the last few days.

Another major issue we want to discuss today is the Department's progress in implementing the agricultural credit provisions contained in the recently enacted Food Security Act. A summary of these farm bill credit provisions has been placed at each member's desk. In my opinion, the 1985 farm bill granted broad authority to the Secretary to deal effectively with any credit crisis which may strike our farm communities. I especially want to know what is being done by the Department of Agriculture to utilize the interest rate buy-down program, the limited resource loan program, and the authority for planting season advance recourse commodity loans to alleviate this year's credit problems.

[The summary follows:]

Summary of Major Provisions in 1985 Farm Bill

CREDIT AND RURAL DEVELOPMENT

INTEREST RATE BUYDOWN:	USDA will operate a $490 million program through Sept. 1988, enabling USDA to pay lenders up to 50% of a reduced interest rate, not to exceed 2% for farms with guaranteed FmHA loans.
ADVANCE COMMODITY LOANS:	Starting in 1986 the Secretary may offer planting season advance recourse commodity loans.
FARM OPERATING LOANS:	For the 3 fiscal years, 1986-87-88, FmHA farm operating loans are capped at $3.48 billion annually. The funds will be equally divided between direct and guaranteed loans the first year. By the third year the division will be $870 million for direct loans and $2.6 billion for guaranteed loans.
FARM OWNERSHIP LOANS:	$520 million will be available annually. In the first year the funds will be divided equally between direct and guaranteed loans. By the third year the division will be $130 million in direct loans and $390 million in guarantees. Each year 25% of the guaranteed loan funds may be transferred to direct loans.
EMERGENCY DISASTER LOANS:	Ceilings of $1.3 billion in fiscal 1986 will be reduced to $700 million in 1987 and $600 million in 1988. Disaster loans will not be available to those can get credit elsewhere or, starting in 1987, to those who can get Federal crop insurance. Disaster loans will not be available to farms larger than family size.
RURAL DEVELOPMENT LOANS:	$340 million in direct water and waste disposal loans will be available annually for 3 years, as will $250 million annually in guaranteed industrial development loans and $115 million in direct community facility loans.
LAND ACQUIRED BY FMHA:	The USDA cannot sell land acquired through FmHA foreclosures if the sale will depress local farmland values. The first priority in sales or leases will go to operators of farms that are not larger than family farms. Leasing priorities will be given to former owners who have a reasonable prospect of success. Sales prices must reflect the probable income produced by the land. Management contracts to administer FmHA-owned land will be let under competitive bidding, with preferences given to local small businessmen. Conservation practices may be required on highly erodible FmHA-acquired land that is sold or leased.
EASEMENTS:	FmHA borrowers who can't repay their loan in a timely manner may have part of their debt cancelled by granting the USDA conservation, recreational, or wildlife easements on cropped land that is classed as wetland, upland, or highly erodible.
SOFTWOOD:	Distressed FmHA borrowers may be able to get loans to plant softwood timber on marginal land. This would reamortize loans and would be payable in 50 years or when the timber is sold.
SERVICE:	FmHA must process loan applications within 60 days and provide funds on approved loans within 15 days. FmHA may allow foreclosed or bankrupt borrowers to remain in the house as renters for not longer than 5 years with first right of refusal to reacquire the homestead property.
CLEAR TITLE:	After 1986 buyers are cleared from liability on liens against commodities bought from farmers unless buyers have been given direct notice of those liens or through a state registry system.

Mr. JONES of Tennessee. We have limited today's hearing to administration witnesses. We are privileged to have Under Secretary Frank Naylor, whose jurisdiction includes the Farmers Home Administration, and Mr. Vance Clark, the new Administrator of the FmHA. This is Mr. Clark's first appearance before this subcommittee.

I want to extend my welcome and assure Mr. Clark that we look forward to a good, working relationship in the coming years.

Since we have limited testimony today, the hearing record will remain open for a reasonable period so that others who wish to submit statements for the record may do so. The subcommittee will also operate under the 5-minute time limit for members to question the witnesses, with the intention of taking as many followup rounds for questions as the members wish.

At this point I want to yield to the ranking minority subcommittee member, my good friend and colleague, Tom Coleman of Missouri, for any remarks that he may wish to make.

OPENING STATEMENT OF HON. E. THOMAS COLEMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. COLEMAN. Thank you, Mr. Chairman.

I am very pleased that we are holding these hearings today to start addressing the credit problems that exist in this country. I think 1986 will be a very eventful year in this particular area. We need to recognize that farmers are making their plans for spring planting. They need to know what kind of operating capital will be available to them in the form of credit from all sources, if not most especially from the Farmers Home Administration.

Rural areas in my State and throughout the Nation are undergoing some of their most difficult economic times of the last half century. But that doesn't mean that we can't survive. Keeping the family working together, working out their financial problems, and creating new economic opportunities are indeed the challenges that all of us face to maintain our rural communities.

We have seen an increase in incidents of the byproducts of financial stress such as family violence, runaway children, child abuse, alcohol and drug dependencies on the rise, as well as the alarming statistic of increasing suicide rates. There are estimates in my State by a university study that perhaps 9 percent of Missouri farmers will go out of business this year for one financial reason or another. Loss of these farmers will have a direct impact upon Main Street businesses, of lost wages, sales, profits, and taxes for local governing units, impacts upon transportation and utilities, city, county, and State governments, and so on, and so on.

In a study recently conducted by the University of Missouri, we found that in 1985 we had over 535 bankruptcies in our State, which was the highest we have had in the farm community in 5 years; 400 percent more than what we had in 1981. Unfortunately, it appears that we are on our way to another 500 bankruptcies this year for our farm communities.

About 45 percent of all these bankruptcies occurred in Mr. Volkmer's and my districts. It is too late to help these farmers, but we hope that we can address some of the credit problems to avoid the potential failures of other farmers who are in debt in order to avoid bankruptcy.

As you indicated, we have two witnesses today, both administration witnesses. I am pleased we have the chance to ask questions of these gentlemen about the delinquency notices that are scheduled to go out later this month.

Farmers Home borrowers in my district are most concerned about how aggressively Farmers Home people will decide to move toward foreclosure. Chaos and havoc could result if Farmers Home decides to move too aggressively. The farmers who are trying to work with Farmers Home should be treated fairly and given every opportunity to continue farming and make their payments.

Just to give you a frame of reference, in 15 out of the 20 Farmers Home county offices in my district we have a delinquency rate over the national and State average of 25 percent. In one county, we have a delinquency rate of over 50 percent. Massive foreclosures in these counties would obviously cause a demise in those particular areas. Towns that are dependent on agriculture will dry up and blow away if their base, which is agriculture, is destroyed.

We did provide $490 million in an interest buy-down in last year's farm bill. I would be interested in hearing from the witnesses on how they are going to implement this and what plans they have made to make it available to our borrowers.

I am also interested in the progress made in the guarantee program, one which does not have a very good track record, and how it's going to work differently this year, and what these gentlemen have done to make it work differently.

I will be asking some questions about the management contracts of inventoried properties that you administer under the amendment that I had passed on to the farm bill.

I would wonder if you might have a comment on the recent proposal from the Independent Banking Association as well as the American Banking Association on a commercial lending program. Also, you might want to comment on the GAO study on Farmers Home lending. Do you feel this is an accurate description? Do you have any response to their conclusions?

And again, we will all be interested in how you feel Gramm-Rudman might affect Farmers Home Administration's lending policies. And I am sure we can come up with some additional questions, time permitting.

I thank the chairman again for holding these hearings and look forward to the results that these questions will proffer shortly.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman. I want to say that I appreciate all the effort that you put forth through this 99th Congress to help us come as far as we have, notwithstanding the fact that we have many, many problems facing us yet.

Now I yield to my colleague, a member of this subcommittee, Tom Daschle, for 5 minutes for any statement he might have.

OPENING STATEMENT OF HON. TOM DASCHLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH DAKOTA

Mr. DASCHLE. Thank you, Mr. Chairman. I don't have a lot of initial comment to make except that I just came from the Veterans Committee. In reviewing the budget for fiscal year 1987, a great deal of the original testimony was an effort to put the blame for the cuts that we will experience in the Veterans' Administration on Gramm-Rudman. I think it is extremely important at the outset of this hearing that we clearly differentiate the difference between the fiscal year 1987 budget and Gramm-Rudman. Gramm-Rudman requires, as everyone, I think, in this room knows, an across-the-board cut if we fail in any other way to meet the $144 billion deficit.

It is also extremely important to realize that in the President's fiscal year 1987 request we are asking for a $23 billion increase in defense. So, somehow, within the rest of the budget, we have to come up with not only a $23 billion increase in defense, but also the cuts that would otherwise come out of defense like they're coming out of everything else.

We are not cutting defense. In fact, we are increasing it $23 billion. In order to reach the $144 billion target, we are taking gargantuan cuts out of everything else, including agriculture. As we set the stage, I hope no one makes the mistake of saying it's Gramm-Rudman that is requiring the kinds of deep cuts that we are experiencing in agriculture, in Farmers Home specifically, as well as other programs in the domestic side.

I am very much looking forward to the hearing. I thank the chairman for his leadership in calling it.

Mr. JONES of Tennessee. Thank you very much, Mr. Daschle.

Mr. Tallon.

OPENING STATEMENT OF HON. ROBIN TALLON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH CAROLINA

Mr. TALLON. Thank you, Mr. Chairman.

I am very anxious to hear what Mr. Naylor and Mr. Clark have to say and how they view the overall farm credit situation.

To let you know of the extent of my interest in Farmers Home Administration, it holds 33 percent of the nonreal estate agricultural loans in South Carolina. Just 10 years ago, Farmers Home held only 4 percent of these loans. But now we are faced with really a more immediate problem, and that is with direct farm ownership loans. Federal land banks are poised and ready to foreclose. Our farmers turn to Farmers Home, and they are told there's no money. Farmers Home supposedly has plenty of guaranteed loan money, but the commercial banks in South Carolina just aren't interested.

Actually, last year we had only 22 guaranteed loans made in South Carolina. I guess probably the people that resist change even more than the farmers are the bankers. They never wanted to participate in the guaranteed loan program, and I don't know why, I don't know what we need to do to improve this program, to get some participation in it. I just don't know what the problem is. I hope you will be able to shed some light on that.

It just won't do anybody any good for the farm credit system banks to foreclose on these people. We already know about their financial problems. I hope this is where Farmers Home can help.

I hope you will see that we have credit that is available to refinance these loans through programs that are workable. I will address that later with some of my questions.

I thank you for being here.

Mr. JONES of Tennessee. Thank you very much, Mr. Tallon.

Now to Mr. Thomas for a statement.

OPENING STATEMENT OF HON. ROBERT LINDSAY THOMAS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA

Mr. THOMAS. Thank you, Mr. Chairman.

It is with a little bit of reluctance that I bring something like this to the attention of the subcommittee, but I thought, since we were going to hold these hearings, perhaps we might be aware of the kinds of conditions that are occurring out there on the farm and the kind of events that have been occurring. We are all familiar with the tremendous pressures on our farmers. We have seen the disaster and tragedy that it has brought to some of our families. This hit my district yesterday morning, the day before yesterday morning when a Mr. Leonard D. Hill from Burke County, who was a friend of mine, in the face of foreclosure by the Federal land bank called his wife into the room and told her that he had 20 minutes to stop the foreclosure sale. And he did that by taking a .22 rifle and shooting himself in the head.

It made national news. Some of you probably saw it. It's front page today in the Atlanta Constitution.

I really don't know how you can draw a succinct conclusion as to what it means, but it's a sign of the times. It's a kind of sign that a lot of people up here in Washington in the administration and in both parties and the Congress have been ignoring, the utter hopelessness that face people like Mr. Hill. And he was not an extravagant man. He owed less than $300 an acre on his 1,300 acres. He couldn't even find a buyer for that.

Yet, here we are, talking about foreclosure. In my own State, where Farmers Home Administration intends to foreclose this year on over half of the 8,000-plus loans that they have in the State of Georgia, the best of my figures. I think you will find those are correct. And for what? There are no markets for the land. There is no resale to Farmers Home Administration or anyone else who forecloses. It does absolutely nothing but drive land values down further and push other farmers closer to the brink.

Now, somewhere—and I don't know when it's going to be, because I have watched for 3 years; and I haven't seen any signs of it yet. But some people in the right places, our Secretary of Agriculture, and our President, and others, are going to have to begin to look and focus on these kinds of tragic events and have to realize that certainly there is a message in what is occurring out there.

I just hope that somewhere in here, maybe out of these hearings and some other things that are going to occur, finally we will get away from this idea that we are going through some simple little normal adjustment that is just natural in the cycles of agriculture and that we are going to come out of it with a leaner, cleaner agriculture. Hell, we're coming out of it with a disaster. And we are seeing good people driven off the land and driven to the absolute end of their wits. And how we cannot draw the right conclusions from that is beyond me.

Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you, Mr. Thomas.

Another member of the subcommittee has just arrived. If you have a statement——

Mr. **Evans** of Iowa. I have no statement, Mr. Chairman.

Mr. **Jones** of Tennessee. We have two other members of the full Agriculture Committee who are with us today, for which we are honored. Mr. Olin, if you have a statement you would like to make at this time, we would accept it.

Mr. **Olin**. I have no statement at this time, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you for being here. I hope you can attend the hearing in full.

Mr. Rose is chairman of another subcommittee. We appreciate your being here.

Mr. **Rose**. Mr. Chairman, thank you. I don't have a statement. As you know, I have some specific questions regarding a report that was done about one of the counties in my district. When you tell me I can, I would like to ask those questions whenever you are ready.

Mr. **Jones** of Tennessee. We will do that when we have heard the testimony and after the members of the subcommittee have been able to ask their questions.

Mr. **Rose**. Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. I see we have a vote on the floor of the House. Before we start hearing the Under Secretary, we will go vote and then return as promptly as possible.

[Recess taken.]

Mr. **Jones** of Tennessee. The subcommittee will resume its sitting.

We apologize for the delay, but there were two votes instead of one. Most of us arrived back here in time to make another trip.

We are pleased today to have, as I have already said, two Agriculture Department officials to talk to us about credit availability and the delinquent loan servicing and lending policies of the Farmers Home Administration. We are delighted that the Honorable Frank Naylor, Under Secretary of Agriculture for Small Community and Rural Development, is to be here with us today and to be heard first. Frank, you may proceed.

STATEMENT OF FRANK W. NAYLOR, JR., UNDER SECRET SMALL COMMUNITY AND RURAL DEVELOPMENT, U.S. DEP MENT OF AGRICULTURE

Mr. **Naylor**. Thank you, Mr. Chairman.

I would first like to take the opportunity to commend both you and Mr. Coleman and members of your subcommittee for convening a hearing on this issue so early in the year. We appreciate the opportunity to work with you, as we have for so many years, in dealing with the very critical issue this year and for several years, and in responding to the credit needs and the problems being faced by many of our farm operators. For many this will be their most difficult year yet. But I also firmly believe it is a bottoming-out year and that we are about to turn the corner, even though we will have some difficult times yet ahead.

In the interest of time, Mr. Chairman, I will defer to Mr. Clark, who does have a prepared statement, so that we can provide the members of your subcommittee more opportunity to ask questions that may be specifically on their minds. We look forward to answering those questions.

Mr. JONES of Tennessee. Without objection. It will be a real privilege and our first opportunity to hear Mr. Vance Clark. Mr. Clark, as Administrator of Farmers Home Administration, you are welcome, as I have said before. You may proceed.

STATEMENT OF VANCE L. CLARK, ADMINISTRATOR, FARMERS HOME ADMINISTRATION, U.S. DEPARTMENT OF AGRICULTURE

Mr. CLARK. Thank you, Mr. Chairman.

I, too, appreciate this opportunity to appear before your subcommittee. I appreciate particularly those kind words of welcome. I tell you, too, that I appear here in the spirit of cooperation, not only today but as time goes on during my tenure at Farmers Home to cooperate with this committee to the fullest extent anytime you would beckon me to do that.

I understand my formal statement has been submitted to you. You have copies of it. I, too, in the interest of time would ask that my prepared statement be presented to you formally, to leave enough time, if we may, for questions and answers.

Mr. JONES of Tennessee. Without objection, the entire statement will become a part of the record.

[The prepared statement of Mr. Clark appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. You may proceed as you like.

Mr. CLARK. Again Mr. Chairman, it is a pleasure to share with you today some of the things we are doing at Farmers Home, why we are doing it, when we are doing it, and what has triggered some of the things that have happened to us in the last couple of months. I think we are anxious to go forward with our new servicing regulations, which we will be happy to explain to you in detail as we go.

We are anxious to plug into our programs this year all of those avenues of relief, those items of relief and salvage that are in the 1985 Food Security Act. We can bring you up to date on our regulations, write and rewrite, as we are now undertaking. So, we will be pleased to share with you information that you might have to bring before us and any other items that would be of particular interest to you.

With that, I would, of course, defer to you and your committee men for questions to either of us.

Mr. JONES of Tennessee. Thank you, Mr. Clark.

Mr. Daschle, you are recognized for 5 minutes of questioning.

Mr. DASCHLE. Thank you, Mr. Chairman.

I am told that the effective interest rate for 1985 is 12.8 percent for all banks, 11.2 percent for large banks, 13 percent for all the other banks, Mr. Clark. I am wondering what will the loan rate be for Farmers Home Administration in the current fiscal year?

Mr. **Clark**. Again, our interest rates, as you know, are mandated by law and certainly spread over our Treasury borrowings, at the present time. And we do review those rates on a monthly basis. They have remained unchanged now for some time. But in our farm operating insured programs, it's presently 10.25, for limited resource loans, it's 7.25, for operating loans. Our guaranteed are negotiable, of course, with the private sector banks, with the mandate that they cannot charge over 1 percent of what they are charging their normal agricultural borrowers, or average agricultural borrowers.

Our ownership loans insure presently at 10.75, and our limited resources loans at 5.25.

Mr. **Daschle**. At mid-1985, bankers had discontinued 4.5 percent of their farm customers. I am told that this is expected to increase to 5.7 percent by 1986. Does the Farmers Home anticipate assuming this additional load, given your budget projection?

Mr. **Naylor**. Mr. Daschle, we expect that the substantial growth of the guaranteed program may tend to reduce that projected number that you just made reference to. Indeed, after a slow start last year, the guaranteed program became a very rapidly expanding program in the latter part of the lending season and is running well ahead this year already of last year.

We have made a number of substantial changes in cooperation with the banking industry to make that program more workable. Those were put in place in September. Perhaps most significantly in the next week to 10 days, we expect the regulations to be issued on the interest rate buy-down program which is associated and was part of the Food Security Act of this year, which will make it possible for interest rate buy-downs of up to 4 percent, 2 percent by the bank, in a concession, and 2 percent by the Government, to be made on loans for periods of up to 3 years, as provided for under that act.

That combination, we believe, will have a significant impact on the capacity of banks to stay with customers they might otherwise have had to turn away.

Mr. **Daschle**. You said that there was a substantial increase in the participation of the guaranteed loan program over last year. That doesn't surprise me, given the fact that you could count most of the guaranteed loan programs on one hand last year.

What does that mean in terms of the percent of rural banks utilizing the program?

Mr. **Naylor**. Mr. Daschle, by late last spring, over 50 percent of the rural banks had been brought under our approved loan program and virtually all the farm credit system.

Mr. **Daschle**. I was asking how many banks are actually using it, not how much——

Mr. **Naylor**. Most are, in the rural areas. And frankly, at the end of the lending season there was a huge surge of activity. We ended up with over $1 billion of guarantees. We have made substantial improvements in cooperation with the leadership of the banking industry to even that program. And the early utilization, although it's very early in the lending season yet, is running well ahead of a year ago. It looks like, from the indications of the banking industry, it will be aggressively used in the Midwest this year.

Mr. **Daschle**. Mr. Naylor, you have been on the Hill so long, and I know that you can gloss over these numbers pretty easily; and it's probably the best thing to do in a case like this. But do you have any specifics?

Mr. **Naylor**. Mr. Daschle, I will supply those numbers for you, but I don't have to gloss over anything this year. The record is going to be quite clear, as it was last year, that we do indeed have an excellent program, one that the banks like, one that they had a major role in helping to improve, one which the farming organizations like, and one that will be very effective and usable.

Mr. **Daschle**. So, you're telling us this afternoon that you don't anticipate that a farmer needing credit, as he goes into the current crop year, is going to have difficulty finding it? Is that what you're telling us?

Mr. **Naylor**. A bank that will properly utilize the guaranteed program should be able to stay with all but their most extreme cases, and we will be prepared to deal with those through the regular Farmers Home Program if that becomes necessary.

Mr. **Daschle**. How will you deal with them in Farmers Home?

Mr. **Naylor**. Through our direct lending program.

Mr. **Daschle**. New borrowers?

Mr. **Naylor**. We can accept new borrowers.

Mr. **Daschle**. Are you planning to?

Mr. **Naylor**. Yes, in the appropriate case. We will encourage commercial banks, however, to stay with their customers and to use the guaranteed program with the interest rate buy-down to the fullest extent possible.

Mr. **Daschle**. Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Daschle.

Now I yield to Mr. Coleman for 5 minutes of questioning.

Mr. **Coleman**. Mr. Clark, welcome. I am glad to see you, and hope that you have a pleasant tenure in your position.

I would like to go back to the testimony and the questions about the letters that are going out and notices, and so forth. The notices were going to go out in January, and that was deferred. When are they scheduled to go out? Do you have a date certain?

Mr. **Clark**. Yes, I do, Mr. Coleman. Those letters will begin to be mailed from our county offices next Monday, February 10.

Mr. **Coleman**. So, I assume that we will be hearing from people, depending on the efficiency of the mail service, by the 11th or the 12th. I am sure you will be manning your phones to await our calls on those dates.

I notice that you indicated that there are several options that an individual might take, and so forth, one, for example, on page 3, to be eligible for a deferral. Could you take us along those steps as to when a person would be eligible for deferral? Specifically, it says that the circumstances were beyond the borrower's control. Does that mean weather conditions and low yields for several years? Would that be a circumstance beyond the producer's control? And what do you consider temporary in nature as far as having a deferral and the need is temporary? Could you embellish that a little bit?

Mr. **Clark**. Well, again, we think that's a very liberal program this year for those borrowers who can qualify. Again, in addition to those items that you have mentioned also there is the commodity price problem as well. Indeed, that is no fault of the borrower. And if they are caught in that catch-22 position, that, too, would qualify him for debt deferral. We will defer up to 5 years of both principal and interest if necessary. That would allow a cash-flow for that operation, the secret being the cash flow must be there. Setting out a 5-year program, we have given all of our county supervisors rather detailed instruction on how to analyze those accounts.

Mr. **Coleman**. Could I ask you then, if a drop in price or a difference in commodity prices is a change in circumstances beyond the control, you would go back to the original cash-flow statement or the original farm plan that this borrower took out? And if the prices had dropped considerably, then he would become eligible for a deferral? In other words, the reality wasn't the same as the anticipated prices that this farmer was going to receive for his product. Is that what you're saying?

Mr. **Clark**. We're looking backwards, obviously, to see what his starting point was but more importantly, looking forward. And we are giving them factors supplied through our Economic Research Service to try to look down the road for 5 years.

Also very important this year is the advance deficiency payments. We think that is going to be a very important item to be considered. Those would be considered in our 5-year plan, especially our 1986 year plan, and would allow them, hopefully, at the end of that 5-year period, to again take up the payment of that deferred debt.

Mr. **Coleman**. How fast, Frank, will you be able to get the $490 million buy-down authority out into the field working for practical purposes?

Mr. **Naylor**. Mr. Coleman, we feel that's very important, in our efforts to have the banks make full use of that program. We hope to have the regulations out on an interim basis, which would allow us to make them effective immediately early next week. It's important that the lenders have adequate time to familiarize themselves with those and to be able to put them into full effect.

Mr. **Coleman**. In your testimony, Mr. Clark, you alluded to the issue of surplus commodities and not allowing loans to be made on the basis of funding surplus commodity production. Reading between the lines, you suggest that the language may be reexamined. You have heard a lot of comments up here, I am sure. Could you tell us what your concerns are now and why you may change the thrust of those regulations that the comment period is run on and that you are now revamping?

Mr. **Clark**. I am sure I have heard more comments than you, Mr. Coleman. We are responding to those comments. I think the original publication of the regs was rather misleading, and that was not our intent at all, to have that club over everybody.

We have been doing this now for dairies for several years and in some cases poultry operations, where there is indeed a surplus in that particular area. The idea was to not finance the expansion of crops that could be considered surplus. That is going to be carefully done and certainly in concert with the Secretary of Agriculture.

Mr. COLEMAN. Mr. Chairman, thank you. I have some questions on the second round.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman.

Now the Chair recognizes Mr. Stenholm for 5 minutes.

Mr. STENHOLM. Thank you, Mr. Chairman.

Mr. Clark, given the date February—the what, 6th?

Mr. CLARK. Tenth.

Mr. STENHOLM. Tenth.

What type of operational and procedural adjustments have you made to comply with the prompt approval of loans and loan guarantees in light of requirements found in section 1312 of the 1985 farm bill?

Mr. CLARK. Well, we have, indeed, spent many long hours instructing our people of how to meet those deadlines. We are very aware of them.

We are very conscious of the deadlines that are on us. Especially in the guaranteed program, when we need to respond quickly to independent bankers and the farm credit system that come to us for guarantees.

We have some staffing problems this year, we are attempting to meet those in another way. And I think that we are geared up for that first onslaught. And marching orders are out there on how to do this.

Mr. NAYLOR. Mr. Stenholm, since you have raised that issue, may I make an additional comment, which I feel obliged to do to the chairman, and to you, and members of the committee?

Under the Food and Security Act there is a requirement that we staff up adequately for timely handling of our farm loans during the current year. And that we should use the revolving fund to pay for the extra staff essentially without restrictions in the use of that fund.

It is our understanding, however, that the Gramm-Rudman provision calls for an offset against our general administrative budget to the extent that we use that revolving fund. Therefore, there is the possibility that as we carry out the intent of the Food and Security Act and, indeed, we intend to do our best to do that, that at some point later in the year after the farm lending season, some adjustments including, perhaps, furlough may be necessary to stay within the realm of the Gramm-Rudman provisions for 1986.

Mr. STENHOLM. I thank you for that comment.

I hope all the members of the subcommittee were listening to that, because the automatic sequestration that everyone seems prepared to accept—I would then hope that this committee is going to be able to make some changes in the manner in which these cuts are made, and take a look and see if this is one area that we might also have some consideration.

Mr. JONES of Tennessee. Mr. Stenholm, would you yield?

Mr. STENHOLM. I would be happy to yield.

Mr. JONES of Tennessee. Would you object if Mr. Naylor was asked to elaborate on just what he said in regard as furloughs are concerned, just to see where we stand there.

In fact, I think that you went into a little more detail than that with me, and I would like for the other subcommittee members to know that.

Mr. NAYLOR. Mr. Chairman, you and I have had some brief discussions on this matter, and I feel that we have an obligation to be sure that the committee understands some of the possible positions we may have to take under the sequestering requirement.

To the extent that we use a revolving fund to meet the provisions of the Food and Security Act in this particular case, for additional staff, we will have to make a dollar-for-dollar offset in other parts of the operating budget for Farmers Home, and our appropriated funds. That is our understanding at this point on the interpretation of the Gramm-Rudman provision for 1986.

That could result in late in the year, having little or no option but to furlough, for whatever time and numbers that may be necessary, personnel within the agency to offset having the additional people onboard during the farm lending season.

We recognize the importance of that and the reason for it being put in the law that we do staff up to that lending season, but it would be inappropriate for me not to alert this committee that is a very likely alternative that we will have to face later in the year.

Mr. JONES of Tennessee. Go ahead, Charlie.

Thank you, Frank.

Mr. STENHOLM. I want to go back. In part you stated that instructions had gone out; are you telling this subcommittee today that all the procedures, the manpower, the guidelines, and regulations, are out there now, and understood by our supervisors at the county level and the State level; and that you are prepared, and have accomplished everything in the spirit of the answer that you just gave me?

Mr. CLARK. Well, that is a little overpowering, sir; but I must tell you, yes, to the best of my knowledge, we have done that.

However, the new regulations, of course, are not out there. They are not able to implement those that we have yet to publish, we are not able to do that. But we have certainly done everything else we can to get those orders out there.

It is hard to get 10,000 people marching to the same beat, I would admit, but I think we are making a very good stab at it.

Mr. STENHOLM. One brief question, Mr. Chairman, what is causing the delays now in the issuance of the regulations?

Mr. CLARK. That is really an overpowering task to us; there are some 32 sections of those regulations, 20-some new ones to be rewritten. We have worked 10 hours a day, I think now for 3 weeks, so even on weekends we get those out. Our General Counsel is now chewing on those, and we are ready now to segment them and pull them out and put them out in the field as soon as possible. Like Mr. Naylor said, next week we will come out with the interest buydowns feature and the debt settlement features.

So, we are really trying very hard to get those out very quickly.

Mr. STENHOLM. I thank you for that answer.

Mr. Chairman, I ask unanimous consent that I be allowed to add some additional questions submitted to Mr. Naylor and Mr. Clark for answer, and have them inserted in the record at this point.

Mr. **Jones** of Tennessee. Without objection, that request will be granted. While we are doing that may I just ask unanimous consent that all members of the subcommittee, and any member of the full committee, have the right to submit questions.

No objection, we will have that.

[The material follows:]

Congressman Charles Stenholm
House Agriculture Subcommittee
on Conservation, Credit, and Rural
Development

SUBMITTED QUESTIONS CONCERNING FmHA

1. Question: A recent GAO report indicates that 30,146 FmHA borrowers who are classified either technically insolvent, or are in extreme financial difficulty, have loans totalling over $5.1 billion. If these borrowers are liquidated, what would be the cost to the federal government?

Answer: A recent GAO study of 1270 properties in 6 states with loans totalling $260,000,000 for an average loan of $204,724.00 had a $149,606 loss/property/case. Based on these figures FmHA loss was 73%; therefore $3.7 billion of the $5.1 billion would be the cost to the government.

2. Question: How do you explain the fact that 41,478 new loans totalling about $2.017 billion were made to technically insolvent borrowers and to borrowers in extreme financial difficulty during the first 6 months in 1985?

Answer: From October 8, 1982 until November 1, 1985, FmHA had a "continuation policy" in effect. Applicants were able to receive loan approval if they had acted in good faith, paid FmHA in accordance with their ability, carried out acceptable management practices, maintained their loan security and demonstrated they could pay all family living and farm operating expenses and the 1985 FmHA loan principal and interest. As of November 1, 1985, FmHA requires an applicant to project a cash flow which is adequate to operate the farm, provide adequate family living expenses, and service all debt.

3. Question: The majority of the $4.8 billion which are more than 3 years delinquent are in emergency disaster programs? What causes the emergency program to have this distinction?

Answer: FmHA emergency (EM) loan regulations have been structured in accordance with the CONACT, with multiple ammendments, which have lead to this development. Specifically;

(1) The emergency disaster program has been historically funded at higher levels; the loan authorities have higher loan ceilings; and the eligibility class is broader. This program represents a larger proportion of our portfolio of farmers, who are in greatest need of financial assistance due to weather related disasters.

(2) The farm ownership (FO) and operating (OL) loan programs regulations require otherwise eligible applicant/borrowers to utilize emergency (EM) loan funds to conserve FO and OL loan funds. We believe that had FO and/or OL loans been made, instead of EM loans, that the FO and OL delinquency rate would be much higher.

(3) The actual EM loss loan authority has historically been at the most favorable interest rate of the FmHA's farm program authorities. When a borrower's farm income does not cover all of the scheduled debts, the borrower will pay the higher interest rate creditors and carry the EM loans delinquent. This is sound business strategy, and it impacts directly on the EM program.

(4) The emergency disaster program implicitly deals with farming operations damaged by natural disaster. The eligibility and security requirements have historically been very liberal which has resulted in FmHA taking on many operations that are more likely to be unsuccessful.

4. Question: Given some of the GAO numbers on the extent of delinquencies, do you feel that the eligibility requirements to obtain FmHA loans should be reconsidered?

Answer: FmHA regulations are currently being revised to provide a more complete analyses of an applicants financial condition. A more detailed review of cash flows and financial statements of loan applicants will insure sound loan making by FmHA.

5. Question: What is FmHA's policy on how long a farmer can obtain credit from FmHA? In other words, does FmHA have a firm guaduation policy for its borrowers that mades it clear that they can obtain credit assistance only for a specified period of time?

Answer: FmHA is developing proposed legislation which will lead to mandatory graduation on the part of our borrowers. This will further assist in reversing the trend toward a greater reliance on Government funds for loans.

6. Question: In areas where FmHA provides a large percentage of the farm credit--in some cases almost all -- what is FmHA doing to increase the involvement of private lending institutions?

Answer: FmHA has taken steps to increase participation in the guaranteed loan program by private credit sources. Some of the actions taken include guaranteeing operating lines of credit and having increased guaranteed allotments available. In addition, the Approved Lender Program minimizes the time required by lenders in obtaining a response from FmHA in order to obtain a contract of guarantee or loan note guarantee. Employees have been directed during training meetings with private lenders to insure that they are aware of FmHA's guaranteed program and what information is required for FmHA to process a loan request. Guaranteed funds are being utilized at a rate which is nearly double that of the same period in Fiscal Year 1985. This is an indication of more active participation on the part of the private sector to finance the needs of farmers for operating credit.

7. Question: What type of operational and procedural adjustments have you made so as to comply with the "prompt approval of loans and loan guarantees requirement" found in Section 1312 of the Food Security Act of 1985?

Answer: On April 21, 1986, the requirements regarding the "prompt approval of loans and loan guarantees" as set forth in Section 1312 of the Food Security Act of 1985 was published in the Federal Register as interim rule. On April 23, 1986, the requirements were issued to FmHA's field offices by "Special Procedure Notice" implementing the provisions of the Act. In county offices where application activity has been heavy State Directors have been utilizing temporary employees and overtime to assure timely processing of applications.

Recall: Stenholm

Mr. JONES of Tennessee. Mr. Gunderson.

Mr. GUNDERSON. Thank you, Mr. Chairman.

Mr. Clark, I guess I join in welcoming you like everyone else, and trying to figure whether we ought to extend congratulations or sympathies for the job you are about to undertake.

I would like to focus on the whole issue of availability of credit this spring, because I think that is going to become very, very key. I have not received evidence in my own area, but in talking with some of my colleagues from certain parts of the country, they have suggested that there has been a rather significant withdrawal or reduction in money available in the farm credit system, which is forcing a lot of fairly solvent farmers to look elsewhere for adequate credit.

Obviously, they are going to be forced to look toward the Farmers Home Administration.

Have you been able to do any analysis of what the credit demands appear to be this spring; and as a result what we can look at in terms of availability?

Mr. CLARK. I must tell you in my travels and talking with my banker friends, those banks are very liquid out there, they are indeed, looking for good, good farm loans, and I am sure they are looking at great troubles as they look at their problem loans. But there is availability of credit out there in the private sector, that is why we are so enthused about our guaranteed loan program, if, indeed, those banks will embrace our program, which they seem to be doing.

Incidentally, our obligations, our bookings so far this year are five times what they were last year in the guaranteed program. So, it seems to be working.

By the same token, our demand for our direct loan programs are down about 27 percent, which tells me that in many sectors of the farm communities, they are kind of waiting. Perhaps they are waiting for our letter; I don't know.

But they seem to be waiting for an opportune time in which to make that decision to go on, to give up, or to shop for credit in different directions.

But I think, again, I am pleased with what I see. We have a challenge, I think in husbanding the funds that we have this year, I think that we have to do that by insisting on graduation for those borrowers who really should not be in our portfolio, and our service, because they are really eligible for credit elsewhere. And we need to graduate those borrowers on.

By the same token at the bottom end of that spectrum are those who we would need to be shaking out, and making other changes, and so somewhere in between of all that demand are those borrowers we need to really concentrate on and service.

Mr. NAYLOR. Mr. Gunderson, if I might get back to the farm credit system: thanks to the effort of this committee and Members of Congress on a bipartisan basis, the legislation we passed, I think, has had a very positive impact on availability of funds to the farm credit system at competitive rates. The market closed very rapidly after the signing of that legislation. The system has been able to sell longer issues. The authorities provided to them as a result of that act gives them considerable more flexibility.

They can, in addition, use our guaranteed program. There is adequate credit available. There will have to be some effort on their part to reinstitute some of those opportunities for individual borrowers; the guaranteed program certainly offers that opportunity.

We do see, however, some significant downturn at least on our direct lending demand. As I have talked with some of the banking community, I think in many instances the availability of advance deficiency payments will be a factor in individual operators electing to use those, to the extent feasible for operating expenses, rather than burdening themselves with additional debt load. And we do see a number of applications for our direct lending down significantly from a year ago at the same time, at least at this point in the season.

Mr. GUNDERSON. Last year we ended up with about 3 to 5 percent of those farmers who had operated in crop year 1984, unable to get funds for crop year 1985, on a national basis, I think.

Are you making any predictions, at this point in time, of the percent of farmers who were in operation in 1985 who will be without a credit home in 1986?

Mr. NAYLOR. Mr. Gunderson, I am not. It is really too early to tell how effective the farm bill will be in providing some margin for operators as a result of payments coming out of those provisions and how they may be used, particularly in the perspective of advance deficiency payments.

I think there is a good basis for feeling that, particularly in the value of real estate, this will be a bottoming out year. This is my view, based on the assessment that we will begin to see stabilization of land prices in most regions later this year, and some reentry into the market by early summer.

Mr. GUNDERSON. Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Gunderson.

Mr. Tallon, you are recognized for 5 minutes for questions.

Mr. TALLON. Thank you, Mr. Chairman.

Mr. Clark, I would like to welcome you before our subcommittee, and look forward to working with you. I have heard a lot of mighty fine things about you.

I would like to go back to one of my latest concerns and it is why the guaranteed loan program seems not to be working in South Carolina. Mr. Naylor had expressed some real optimism earlier, I think he said that we are having five times more applications than we had last year.

Certainly you have had a chance to look at this program. Can you tell me why, especially the commercial banks and farm credit system banks seems to be rejecting this in South Carolina?

Mr. NAYLOR. Mr. Tallon, I don't have a good answer. That is not a pattern across the Nation. In the Southeast in the late 1970's, small commercial banks by and large withdrew from agricultural lending and relied primarily on the Farmers Home Administration and the farm credit system. Even the farm credit system withdrew to some degree in some regions.

They are not nearly as active in agricultural lending as the midwestern banks are. However, by late spring on a national scale, but again predominantly in the Midwest, the guaranteed program had really taken off, and every indication is it has taken off and then some this year.

We have taken a number of corrective steps in direct concert with the banking organizations and the farm groups this summer to overcome each of the problems they felt they had last year.

I guess my advice would be, and we will take it as our responsibility, that your bankers need to go back and do some homework. They are missing a good opportunity to service their communities, certainly, one that the banks in the other parts of the country are availing themselves of.

Mr. TALLON. Well, I am glad to hear that this program is going better in other parts of the country, but I would like to say to Mr. Clark, that Mr. Ed Pittman, our State director in South Carolina, is one of the finest possible gentlemen that I have ever had to work with in any capacity, and I understand that he is out in his automobile going across the State talking to some of our bankers now. This man is really concerned about the situation, as I am concerned.

Is there anything we could do from up here to help educate our bankers, and I really want to look at some figures to see if this is a problem that only South Carolina has.

What else could we do to get in there, to get our banks, Mr. Pittman just riding around the State in his car is not going to be enough. I said earlier that we had 22 guaranteed loans in South Carolina last year.

I think you looked a little shocked when I said that, maybe my figures are wrong, I don't know. But obviously something is not working there.

Mr. CLARK. No, your figures are not wrong. There were 22 loans, a little over $3 million put out in guaranteed loans.

If you are volunteering to help, Mr. Tallon, I would certainly take that flag, and if you will I will be happy to give you a list of the banks we think you ought to be targeting on. If you would like to drop them a line to encourage them, I think it might help.

Mr. TALLON. Thank you; I would be happy to do that, Mr. Clark, and maybe I could work with you. I need to do something more than drop them a line, it is a real critical situation in South Carolina.

Let me ask you this; what is an approved lender under the guaranteed program, can you define that for me?

Mr. NAYLOR. Basically, that was a program we developed to short circuit the redtape which had come up around our old regular program to the point that any sensible banker would not have touched that guaranteed program with a 10-foot pole.

The approved lender program preapproves the lenders as a qualified agricultural lender; it removes most of the paperwork; it allows them to use their own forms; it allows them to get a quicker turnaround. The loan is not completely reevaluated by the agency as the regular guaranteed process is. It essentially cuts through all the redtape, much as the SBA approved lending program does in that agency.

Mr. TALLON. Have you looked at the possibility of qualifying individuals as approved lenders?

Mr. **Naylor**. Well, the qualification is by bank; but as part of that qualification, it is presumed that they have trained agricultural loan officers, one or more, in the bank employment. That is provided for as part of the qualification process on the approved banker arrangement.

Mr. **Tallon**. What I am trying to tell you is we actually have some businessmen, individuals in South Carolina, I know of a case or two, where these people with the Farmers Home Administration guarantee would like to make a loan. And as I say, we only had 22 loans made last year. I wish that, possibly, you would look at the possibility of extending those guidelines where individuals might be able to participate.

Mr. **Naylor**. Mr. Tallon, I know what you are alluding to. Current law would not permit us to do that. It requires that we deal with a recognized financial institution, for example, a commercial bank or the farm credit system.

However, there is adequate banking capacity in your State if they will use the program and reenter agricultural lending. Part of our problem may well be in your instance, and other parts of the Southeast, to encourage commercial banks who have left the agricultural market to reenter it in an aggressive fashion, with or without our guaranteed program.

Mr. **Tallon**. Thank you.

Thank you very much, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you, Mr. Tallon, for your questioning.

Mr. Cooper Evans, you are recognized for 5 minutes.

Mr. **Evans** of Iowa. Well, thank you, Mr. Chairman.

Mr. Naylor, earlier in the questioning Mr. Daschle commented on the small utilization of the program, and I would like to say that I think the record of the Farmers Home Administration in expanding its regular guaranteed loan program is rather remarkable. I have had the General Accounting Office take a look at that for me, and they haven't published the final report yet, but according to their numbers, the increase in those guaranteed loan programs for 1984 over 1985 was over 800 percent, in terms of both dollars and number of loans granted.

There is, of course, a great discrepancy between the debt adjustment program which was little used in the regular guaranteed loan program, I think maybe you touched on that, but I haven't got it terribly clear in my mind; do you see the debt adjustment program assuming a much larger role this year as compared to the regular guaranteed program?

According to my estimates here you had about 15 guaranteed loans for every one under the debt restructuring program; is that going to shift this year, do you think?

Mr. **Naylor**. Mr. Evans, I think you will see that the sound lending principles that were incorporated in that debt adjustment program will become part of the basic guaranteed program, and the use of the interest rate buydown provisions in the food and security act, will have very similar impact to some of the provisions that were in that other program a year ago.

And indeed, I do expect the banks to use these provisions. It is something that they had requested and felt very useful. The interest rate buydown program will be a very effective tool for many banks to use and will help them stay with borrowers they otherwise would have had to leave.

But we do expect to see virtually the entire agricultural lending community actively engaged in that guaranteed program during the course of this coming year.

Mr. EVANS of Iowa. If you had an 800 percent increase in the number in utilization of the guaranteed program in 1985 compared to 1984, you commented briefly before about the substantial increase in 1986 over 1985; are you going to have comparable percentagewise increase?

Mr. NAYLOR. I don't think we will do an 800-percent increase again, but we will certainly see, probably, closer to 100 percent this year as we utilize the authorities which were provided by Congress.

Mr. EVANS of Iowa. To go to Mr. Thomas' question, and Mr. Tallon's question, about the problems in the Southeast, you gentlemen might be interested in some of this data, because one of the things that I found to be very shocking was that for the States that you are concerned with and several others in the southeastern part of the United States, there were fewer than 100 applications received in the entire State for the guaranteed program in 1985. And clearly, it is not terribly fair to blame the Farmers Home for not meeting the credit needs under that program, if there are only 100 applications, no more than 100 applications in each of those southeastern States.

And, I think, that it is a fair statement that the reason that it has been so successful in the Northern Plains and and Central States is the participation of those local bankers.

And, I think, that is what we have got to focus on to get that program going in some of these other parts of the country.

I yield back my time, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans.

I would like to comment on what you said, Mr. Evans, about the applications.

There is another story, another side to it, also. If the banks tell you that they don't want an application, there is not much sense in offering one; that is the experience that we have had in the areas that I am familiar with. We haven't taken a gun and gone out to the bank and said, take this application.

Mr. Thomas, you are recognized for 5 minutes.

Mr. THOMAS. Thank you, Mr. Chairman.

I might respond just a little bit, but I would like to see this information from my good friend, Mr. Evans.

But this is exactly what has happened, such a high percentage of our banks in the South, in the State of Georgia, particularly, out of the agricultural lending business, period. And they are not looking for any way to get back in it, let me assure you.

Unfortunately, back in 1977, when much of the SBA money was made available, many banks found that as a means of unhitching themselves from agricultural liability.

So, I have not found that the guaranteed programs have been working well in my State. Let me go on, most of the questions I had along those lines, I think, we have touched on.

I wanted to ask at this time, Mr. Clark, I don't know if you or Mr. Naylor, which would care to respond.

Do you have adequate money for operating loans out in systems at this time?

Mr. NAYLOR. To the best of our ability to make that judgment at this point, we do, even with the sequestering order. The thing we really haven't been able to make a judgment on is the fact that a number of operators and their banks appear to be using advance deficiency payments, rather than increase in debt service, which is a good, prudent decision.

But indication of that may well be the fact that we have received 20,000 fewer applications, at this point, for direct Farmers Home money this year than we had at the same time a year ago.

It would appear that many operators are, indeed, looking to use program dollars to start their crops this year as opposed to additional borrowing.

Mr. THOMAS. That figure is 20 percent fewer?

Mr. NAYLOR. 20,000 fewer applications.

Mr. THOMAS. 20,000 fewer; OK.

Well, I have already begun to pick up reports from people calling me at home, and saying, we have been to the FmHA office, and they say they have no funds available for operating money, and there is no use in making application. Now, I don't know how to tie that down, I just met the new administrator for the State of Georgia, who came down and spoke with me this week, I do not make it a practice to call the FmHA offices. I go through the State headquarters, and the State office up in Athens will do that, but as well as that we have had some who made the statement in one particular office, that we will finance less, we will finance maybe, 1 out of every 25 applicants coming here.

So, with those kinds of comments greeting applicants at the very start, that there is no money there to begin with, and that 1 out of 25 will be financed, it just seems to be very discouraging for those who are going. So, I would like to go through the State head and ask him to give me some clarification of that.

But as far as you understand, there should not be any situation where a local office would be greeting people coming in to make application with the statement that there is no money to make operating loans with?

Mr. NAYLOR. Mr. Thomas, at this point in the year, no, we have no reason to think that should happen. But I am obliged to tell you that we do intend to live within the budget figures that have been established for us for the 1986 operating year, which are within $900 million of the total of what we had for last year, which was a record year for us.

We will not be using the procedure that we used last year; nor will we be moving funds around quite as fast as we did because of that procedure as a year ago. And there may be, later in the season, some isolated cases which may run short of funds on a localized basis.

We will attempt to move money within the States to deal with that; at this point in time, because of the appearance of use of program dollars, it does look as though we will be fairly close on the mark, but it is a little early in the season for us to know that with certainty. We will monitor it as we have done last year and the year before, daily. Mr. Clark, and I, both get a daily report telling exactly where we are, how we compare to a year ago at the same time, on a State-by-State as well a national basis. We will continue that very tight monitoring throughout the lending season.

Mr. THOMAS. Just for my own information; just exactly how do you disperse funds to various offices within a State?

And what happens if those funds are not utilized and there is a strong demand in another area, then you do some shifting in of funds; is that correct?

Mr. NAYLOR. That is correct, Mr. Thomas.

Over the years, many, many years in several administrations, a formula basis of distribution of funds to States has evolved, which by and large reflects the demand of that State and its lending activity over an extended period of time. State directors have some discretion, but generally, similarly distribute funds within their individual offices.

They do have the discretion to move funds around within a State based on shifts in localized demand. And we normally have what we call a pooling process as we get into the latter part of the season to take funds from those areas where the demand has not been present and make them available to where the demand has been higher than expected.

Mr. THOMAS. Thank you, Mr. Naylor.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Thomas.

Mr. Stallings, you are recognized for 5 minutes.

Mr. STALLINGS. Thank you, Mr. Chairman.

You say you had $900 million less this year?

Mr. NAYLOR. Under the current estimate, including the Gramm-Rudman expected sequestering, that would be correct. Last year actual was $5.92 billion for farm lending; under the current estimate, including the adjustment for Gramm-Rudman, it will be $5.092 billion available for farm lending.

Mr. STALLINGS. Now, does this include money that is being paid back monthly by——

Mr. NAYLOR. This is new loans.

Mr. STALLINGS. This is new money.

What happens to the money that is paid back into the system, the interest that you——

Mr. NAYLOR. That goes back into a revolving fund and is treated differently from what you are asking.

As I understand the question, you are asking me how many loans can we make in dollar face amount; that was the number I just gave you. Payments by an individual borrower go back into what is called the agricultural insurance revolving fund, and, in effect, regenerates it. Any shortfall in that fund in the number of dollars necessary to meet our lending authority is made up by appropriations.

Mr. STALLINGS. Mr. Clark, I understand that there have been several policy changes in the economic emergency loan program, particularly with respect to determine eligibility for disaster loans; can you detail these policy changes for me?

Mr. **Clark**. I think the family-size regulation is important to us. I think we found historically that a great many of those disaster loans were going to very large corporate farmers, corporations, and really were not, we think, meeting the intent of Congress, and those regulations have now been tightened to say that it must be a family-size operation.

Also, there is a limit of half million dollars; at one time there was no limit. And I might point out that our delinquencies now are $5.8 billion delinquencies, and our whole portfolio almost $12 billion, 3.8, I believe, are disaster loans, which tells me our disaster loans have been a disaster, not only for the agency, for the taxpayers, as well.

So, it is really an attempt, I think, to better put those loan dollars out to serve the right people who would need relief in disaster areas.

Mr. **Stallings**. Let me give you an example; how would the FmHA treat a family-operated farm, consisting of a father and two sons, no full-time employees, that for taxes and other legal purposes is organized as a subchapter S corporation; would they qualify for disaster?

Mr. **Clark**. Yes; they would, as a family operation.

And we are trying to clean up that description once again, I guess it has been attempted many times, but it really is going to come out for blood or marriage as a family operation.

Plus the size, too, I think, also, will be there, deck size, and so on.

Mr. **Stallings**. Acreage size as well?

Mr. **Clark**. No. I say no, because again, the county committee in each of our counties makes that determination, what is a family-size farm.

We will give them the guidelines, but certainly a family-size operation in Nevada is much different than in South Carolina. So, we need to make that decision.

Mr. **Stallings**. I understand that cashflow is also considered in the disaster qualifications; is that correct?

Mr. **Clark**. It would be, I think, in any case, it would be, and it has to be there. I am trying to remember what you mean, I don't think it is written in the regulations as——

Mr. **Stallings**. I have had several farmers tell me that they qualify for disaster, we had a phrase in the potato growing areas, that was several of my counties were subsequently declared disaster areas, defining cashflow because of disaster is going to be very difficult. And, yet, if that is a requirement to qualify for the loan, it seems to be a self-defeating regulation.

Mr. **Clark**. Well, the problem would be for payback, obviously, if disaster is really giving them a big setback, the cashflow has to be projected into the future to pay back that disaster loan; I think that would be a requirement that would be stipulated for the future.

Mr. **Stallings**. How quickly will these new regulations be issued to the field committees so that they can start processing a backlog of these applications, particularly in my State of Idaho?

Mr. **Clark**. We are working, as I say, Mr. Stallings, as fast as we can on that, we are trying to segment those sections of the 1985 Security Act to get them out as soon as we can to help in those areas that are needed. I wish I could give you a firm date. We are aiming for just as soon as possible with regulations, hopefully within in the next 35 to 40 days we will have that whole ball out. So, I hope we are ready.

Mr. STALLINGS. I had a call this morning from a gentleman involved with milking cows, he cannot get any money to even buy feed, because of the disaster that he went through this last year, and his farm does not qualify essentially because of the problems with the backlog here; he is just at his wit's end. And he wants to know is there any hope, is he going to have to take up bankruptcy because of this backup, or is there something I can tell him to give him some immediate hope?

Mr. CLARK. He should be able I would think to get an operating loan to carry him to that point of disaster payment.

I don't know what his cash condition is. But if it makes sense, and he has got immediate cashflow today from his dairy operation, he should be able to get an operating loan, an interim loan to carry him to that disaster payoff.

Mr. STALLINGS. Mr. Chairman, could I have 1 more minute to just follow up?

How much discretion does the State director have in implementing these programs, does it vary from one State to the next, will the director in the State of Idaho implement and interpret things differently than say, the director in the State of Georgia?

Mr. CLARK. Well, we try to give a good description of what the program is, to describe it. We try to get those people marching to the same orders; but lending officers, whether in private sector or in Farmers Home, do have discretionary authority; they have to analyze credit a little differently. I think they have to be flexible. I used the word "creative" the other day, and maybe that was a mistake, but they do have to be creative as they try to structure credit.

They have to be able to move in many directions. Yes, they have discretionary authority; and they should have it.

Mr. STALLINGS. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Stallings.

Before we recess for a vote I would like to recognize the chairman of the full committee, Mr. de la Garza, who has been here for some time. Mr. Chairman, we always appreciate your interest, the very fine support that we have had from you.

I would like to recognize you at this time, since you might not be able to come back for some reason.

REMARKS OF HON. E (KIKA) de la GARZA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

The CHAIRMAN. Thank you very much, Mr. Chairman, and I thank you for calling these hearings.

I thank all of the witnesses, those that have appeared before, and those that might afterward, very briefly, because we have a series of votes on the floor.

Mr. Naylor, the last 2 or 3 weeks I have traveled to Texas, California, Idaho, Georgia, and the concern of the farmer as he approaches me at a meeting, or after a meeting, or before a meeting, now has switched to credit; that seems to be the major concern—

credit, whether he is viable, whether he is on the verge, whether he is in trouble, regardless of credit. At a hearing we had with Mr. Stallings in Burley, ID, a local banker came and said that he had gone to the extent of even making some regular loans, because of the intricate, cumbersome way that the guarantee or the buydown was just too much of a problem, that perhaps if we made it similar to the SBA guarantee it might be easier for them.

Now, I haven't had a side-by-side look, but can you clairfy that; or would you, or the administration, be agreeable to simplifying, at least to the extent of SBA, if there be a difference?

Mr. NAYLOR. Well, Mr. Chairman, that is what fundamentally the approved lender program was designed to do. And I would suspect that the banker involved may not have taken the time to come into the agency and look at the revised program, and particularly, the revisions that we worked out this last summer with the banking organizations.

The improved lender program does, very closely parallel the SBA program. It was intended to eliminate paperwork by allowing the banks to use their own lending forms that they are familiar with. There is only one from which is the certification of all the various Government requirements on EEO, and so forth, that is required in addition to the use of their own forms.

So we very closely parallel those SBA procedures. And it may well be that particular bank had not been back into the agency and taken a look at the approved lender program.

Certainly, under the old guaranteed program that would have been a justified criticism.

The CHAIRMAN. Well, he didn't seem to think so, and we just go back and we haven't had an opportunity to take a close look at it. And we will; and I hope that you do too.

Under the situation we find ourselves in, it is very difficult because even if it is a viable operation, they are having difficulty getting funding now for this new crop year.

I have been looking through the budget; how did you come out on the proposed 1987 budget?

Mr. NAYLOR. Mr. Chairman, we are tracking very similarly to the Food and Security Act with regard to lending authorities. That places virtually all the lending activities in Farmers Home in agricultural lending. Our reductions with regard to deficit reduction, primarily are in nonagricultural lending areas.

The CHAIRMAN. I have a little bit of question and/or maybe statement on the family farm. I am getting concerned that some of our public officials, some of our colleagues, and even some of our farmers are starting to think small, equating it to family farm. I now feel that some people think that the family farm is ma, pa, the kids, a dog, the cow, a couple of chickens, and 40 acres. And 40 acres is a thing of the past.

I still insist that a family farm, operated by the family, sometimes without any outside help, can be 4 acres, 40 acres, 400 acres, or 4,000 acres, and I think we have gotten now to where there is some interest of targeting, targeting to $20,000 or $25,000—this is just me talking—and that is charity. And we don't want charity.

The farmer is not looking for charity. He is looking for parity, equity, and some assistance from the Government to undo the mess the Government helped get him in. I would hope that when you think of the family farm you think family, and not size, and not amount. Because Texans think big.

And 40 acres, now, no one, I dare anyone to think that a family can make the necessary income to live on 20 or 30 acres any more. And there are some now that think that with a stand in front of the house on the highway, or a farmer's market out in the town, the family farm is somebody with a garden, or a few vegetables. That is not the answer to the problem of American agriculture.

I hope you don't get drawn into this thing that family farm is ma, pa, and the kids and 20 acres, because the acreage viable economically is probably between 200 and 400 acres now to make a living. And we should not aim, or target, or limit the size or the need of the operation even though it be only a family farm. I give you that only as my personal opinion, but I hope you will get to thinking that way.

Mr. NAYLOR. Mr. Chairman, I appreciate that observation. Frankly, we could use some counsel with the members of your committee, and on the Senate side, also. We are finding an enormous disparity as a result of the requirement in the Food and Security Act that the family farm size be defined, as to what the members appear to intend, ranging all the way from your description of essentially 40 acres to the largest corporations. Indeed, the effect of that legislative change may in the end be more restrictive than what we were doing before.

But we need some work with you, because I do not want to see us restrict down too tightly, and get in the wrong ballpark. There are cases where large size or even additional employees is a normal practice within the area.

The CHAIRMAN. An investor-owned corporation, or a segment of a conglomerate, or a publicly-owned corporation, we are not talking about that.

Mr. NAYLOR. No.

The CHAIRMAN. I have a constituent whose wife passed away; with the Texas community property law, she left her half to her grandchildren. He came to me and said, I now have 22 partners. He is barely making it, but he is farming 40,000 acres.

You would say, well, he is big. Well, he is not big; it is a family operation. And the family now has grown to 22 grandchildren.

Here in this committee and in the Congress you are going to find that difference, you will have some not farsighted individuals who are talking of targeting to 10 or 20, mostly by their district or by their area, really. But we need to define that, if we are going to say family farm, by golly, we mean that family, and it is not going to be limited to 20 or 40 acres, because that is not a viable entity anymore. We will be very happy to work with you to see that.

I know that we can't define 1 man-hour, 2-year man-hours, that doesn't work anymore. We have a new definition.

My definition would be if the family operates it and derives all means of support for that family from that operation, that is a family farm. Forget the acreage.

Mr. NAYLOR. By and large that is the thrust of the regulations we are now developing. But even that, Mr. Chairman, in some areas where specialty crops require labor for picking, and so forth, becomes troublesome.

We would appreciate your assistance, and that of the committee, to help us resolve that issue that was brought up.

The CHAIRMAN. We would be happy to work with you.

Thank you very much, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Chairman, and if you want to continue after we come back——

The CHAIRMAN. No, I have concluded. Thank you very much.

Mr. JONES of Tennessee. The House will now have two votes on the floor, so we will stand recessed until we return.

[Recess taken.]

Mr. GLICKMAN [acting chairman]. Mr. Jones' staff suggests that I go ahead and ask a couple questions, and the first question I wanted to ask was—I was not here and maybe, Frank, you said this, I do not remember, but that you had 20,000 fewer applicants for direct loans?

Mr. NAYLOR. Direct operating loans in the file so far this year as compared to the same date 1 year ago.

Mr. GLICKMAN. Does that reflect the fact that according to the Census statistics we have as many as 400,000 fewer farm families in the U.S. Census? We have had a decline in the number of farm families, have we not, in the last year?

Mr. NAYLOR. There has been a decline as there has been in most of this century, but that has not affected our number of applications at any time that I have been here. No, I think it is probably—my assessment is that it is an effort on many operators' part to use advance deficiency payments and program dollars rather than additional borrowed funds for their operating needs, and they may be waiting to see how much of that they can cover before they come in for loan dollars.

The banks are also—the commercial banks in the Midwest are following the same practice of trying to set up their programs this year to use as much as possible for current operating costs the advance deficiency payments.

Mr. GLICKMAN. You do not trace the few loan applications to any diminution of the farm families then?

Mr. NAYLOR. No. There is no correlation to that; and if you look at what we call a family-sized commercial operator, there was no substantial decline in those numbers from the 675 they were at at about a year ago.

Mr. GLICKMAN. On page 7, Mr. Clark, of your testimony you talk about a proposed regulation that would allow the Farmers Home Administration to limit loans for the production of farm commodities that are in surplus. As I understand it, you are proposing some regulations in this area; and, as I understand it, you have changed your proposed regulations. I wonder if you might tell us a little bit about that.

Mr. CLARK. These were proposed regulations that were published a month or so ago, and the comment period was the end of January. We are now analyzing those comments.

That really was aimed at financing expansion of production of surplus crops. I think we have been very careful of—what we were doing in the dairy industry in the couple past years and poultry, but I think we have changed our thinking on it. The regulations that are in final form will be, I think, much more acceptable than our first blush publications were.

Mr. GLICKMAN. Will you define surplus commodities in the regulation?

Mr. CLARK. Yes, we do.

Mr. GLICKMAN. What commodities are in surplus?

Mr. CLARK. I will be happy to submit to you a copy of our proposed regulations. A surplus commodity is an increase in production of a commodity over an established base for farm operations, and that base is established by calculating average annual production of that commodity over the past 5 years and that type of thing.

Mr. GLICKMAN. Is wheat a surplus commodity?

Mr. CLARK. That is a determination by, I think, the Secretary of Agriculture.

Mr. NAYLOR. It would be a discretionary determination. But the intent of the regulation was and continues to be to deal with the question of new starts or a substantial expansion of existing operations. It would not preclude any existing operator from obtaining an operating loan or the necessary funds under any of our programs.

Mr. GLICKMAN. How about a new operator that would want to go into——

Mr. NAYLOR. A new start?

Mr. GLICKMAN. Yes.

Mr. NAYLOR. It would apply to a new start if it was in an area that had been determined by the Secretary, a commodity such as dairy or poultry, where primarily it has been under use. It would come under that category if the Secretary so designated it.

Mr. GLICKMAN. I want to go back to my question. Is wheat covered? Is corn covered? You said it was in the discretion of the Secretary?

Mr. NAYLOR. The Secretary would be required to publish the intent to use it with 30-day advance notice, I believe.

Mr. CLARK. Yes.

Mr. NAYLOR. Then there would be a time certain it would apply, and it would apply only to circumstances involving an expansion, not existing operations or operating loan requirements.

Mr. GLICKMAN. But would I as a farmer know in advance which commodities might be subject to this?

Mr. NAYLOR. Yes. It would be in the Federal Register. It would be public information. The intention to do that, there would be 30-day advance notice before it could be done if the Secretary elected to do it; and, again, and most importantly, it will apply only to expansion, not to the existing operation or the existing operating needs.

Mr. GLICKMAN. But, again, Mr. Clark read kind of a definition for this surplus commodity which has to do with——

Mr. NAYLOR. Relates to the individual, assessment of the individual operation. And in any additional information we would be happy to work with the committee to detail that.

Mr. GLICKMAN. The farmer would not know which commodities are covered until such time as 30 days beforehand. Would I know—

if I wanted to find out from you today is wheat covered, could you tell me that?

Mr. NAYLOR. I would tell you today we have no intention of doing any grains. This was the deal with the particular problem in the dairy and in some cases in the poultry industry that occurred in the late 1970's and early 1980's. We attempted to deal with them and our attorneys told us we needed to put it in formal regulatory form and that resulted in this publication.

Mr. GLICKMAN. Let me ask one more question. The advance under the farm bill, you are given authority to implement an advance CCC recourse loan?

Mr. NAYLOR. Not us.

Mr. GLICKMAN. But the Department.

Mr. NAYLOR. The Department.

Mr. GLICKMAN. It ties into you because, as you indicated before, the number of direct operating loan applications were down because of the advance deficiency payments and this kind of thing. Do you know if that is going to be implemented by the Secretary or are you going to recommend any implementation of these advance CCC recourse loans?

Mr. NAYLOR. I do not have that information, and I do not know the answer to that question.

Mr. GLICKMAN. Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Glickman.

We had one round of questioning now; and if there is no objection, I am going to defer to Mr. Rose, who is a member of the full committee, for the purpose of questioning the witnesses regarding a request that was made about a year ago in regard to discrimination by the Farmers Home Administration in the State of North Carolina. You are recognized, Mr. Rose.

Mr. ROSE. Mr. Chairman, I have here a copy of a memorandum dated January 24, 1986, signed, which was mailed to Mr. Samuel J. Cornelius, director of the Office of Advocacy and Enterprise regarding an investigative report on Robeson County, NC. It says in this memo that you have personally called Mr. Larry Godwin of North Carolina, a State director, and reviewed with him the contents of this report; that you have also counseled him relative to the perceptions of discrimination that do exist. You also say that you have asked him to closely monitor the activities by the Robeson County Committee to ensure that they are not exceeding their authority now or in the future.

Are you familiar with this report that accompanied the memorandum?

Mr. CLARK. Yes, I am, Mr. Rose.

Mr. ROSE. Can you explain how it was sent to this committee?

Mr. CLARK. I am sorry. What?

Mr. ROSE. Can you explain how it was sent to the Agriculture Committee?

Mr. CLARK. No, I cannot. That correspondence was in agency. I have no idea.

Mr. ROSE. Well, I thought it was unusual for us to receive a copy. I want you to know that we did not go down and seek it, but it arrived in the mail up here, no cover letter, from USDA; and I would not be here questioning you today if I did not have a copy of this because this, I felt, was an interoffice report. Could you explain what are the perceptions of discrimination you talk about in this report?

Mr. **Clark**. As I recall, that was a county committee that was leaning, I understand, the other way. I think it was a black farmer involved. They were making decisions as to not only eligibility, which is, indeed, their responsibility, but I believe they were attempting to make a decision as to the creditworthiness of that applicant, which is beyond their responsibilities. That is not their task or their mission. And I believe, as I recall, that committee even made a trip to Washington at their own expense to appeal the decision not to make that particular loan, and that was certainly beyond their responsibility as well.

And my counseling with the State director was in that direction; that, indeed, if that committee was doing things that were beyond their responsibility, he ought to be aware of it and counsel that committee not to let it happen again.

Mr. **Rose**. Well, the questions were written with the notion that your office had sent this to us and a notion that I challenged when I read the report, and so I will certainly change the questions a little bit to you.

I will read you the front sheet. You say, "I read with great interest the investigative report on Robeson County, NC. And while the allegations of discrimination were not substantiated, the report does, indeed, indicate that perceptions exist of inequitable treatment by the county committee. I personally called the North Carolina State director, Mr. Larry Godwin, on January 23, 1986, and counseled him relative to the perceptions of discrimination that do exist. I have asked him to closely monitor the activities by the Robeson County Committee to ensure that they are not exceeding their authority now or in the future. I have also asked Mr. Godwin to personally counsel the Robeson County Committee."

Why did you feel all that was necessary?

Mr. **Clark**. Well, Mr. Rose, I am a hands-on manager. I guess I carry that over from the private sector. When I want something done, I want it done correctly and so I, indeed, go right to the man who is in charge. And I feel if anybody can cause something to happen, it ought to be the State director, and I hold him responsible for it. So I felt it was necessary. I will do that to any of my 46 State directors.

Mr. **Rose**. Well, were you aware that I was going to ask you any questions about this today?

Mr. **Clark**. No. I am terribly surprised and disappointed that you have in-agency correspondence mailed to you voluntarily.

Mr. **Rose**. I am not disappointed I have it, but I want you to feel reassured it came in a plain wrapper to this office and I was not here and my staff reported it to me. But there are some serious allegations in here—like one of the county members reportedly—one of the county committeemen reportedly asked a borrower to put a barbecue on for him when he was running for sheriff and when he refused to do it, his credit was cut off and suddenly his hogs became FmHA collateral for the first time. There is a lot of cute stuff here, and the civil rights violations. Let me read just a few of these things.

"No one in the county FmHA office in Robeson County had received any civil rights or Equal Credit Opportunity Act training." That is going on right now. Nobody has had any of that. It is in your report. It is a minor point, but if you are handicapped, with no bathroom facilities accessible to handicaps, Senator East would not be a visitor in your office there, obviously.

"Whites and American Indians had served on the Robeson County Committee. However, there is no record of any blacks ever serving on the Robeson County Committee. The population of Robeson County is 40,000 whites, 35,000 Indians, 25,000 blacks. Minority-designated attorneys in the county consist of eight American Indians and one black."

Well, I hope that your staff in Raleigh and that your staff in Robeson County will take these very seriously, and I think you probably ought to let them know that I have a copy of this report and that I am going to be watching very carefully for some specific changes and we might have to ask some more questions. Please, shape that operation up.

Mr. **CLARK**. I appreciate your concern, Mr. Rose. I hope to take your name off the mailing list. [Laughter.]

Mr. **ROSE**. Either that or the secretary was looking for a job in my office or something, but under Gramm-Rudman we are cutting back.

Mr. Chairman, I do not have any further questions.

Mr. **JONES** of Tennessee. Thank you very much, Mr. Rose. We appreciate your presence with us today.

There are not many of us left, and I have several questions I would like to get on the record. Mr. Coleman has another question or two he would like to ask as well.

Mr. Naylor and/or Mr. Clark, in the fiscal year 1987 budget that was submitted this week it states that a greater emphasis be placed on Farmers Home guaranteed lending and, of course, this policy is consistent with the recent farm bill that was enacted.

However, the budget also states that a 1-percent origination fee will be assessed on direct loans providing about $13 million in additional revenue. I construe that in my philosophy to be a user fee.

First, what I would like to ask, do you believe you already have authority to impose this origination fee without a legislative request?

Mr. **NAYLOR**. Mr. Chairman, there is some disagreement with regard to whether the authority clearly exists without legislative action; and if it becomes determined it is necessary, we would submit the appropriate legislation. These types of fees are consistent with other credit programs; that if you would go through the total budget throughout Government, user or loan fees of one type or another are proposed for a wide range of credit programs within the total Federal environment.

Mr. **JONES** of Tennessee. What you are saying is there is some doubt as to whether or not you have the authority?

Mr. **NAYLOR**. That is correct, Mr. Chairman. It is not entirely clear and if in the legal review it is determined that is the case, then appropriate legislation would be pursued.

Mr. **JONES** of Tennessee. Would you have any idea, if you do have the authority, how you would implement a fee of this sort?

Mr. **Naylor**. We do not and we have not addressed it at this point, Mr. Chairman, because of the work on the farm bill, to get it in place and, frankly, we have not yet really sat down and reviewed this particular issue from an implementation perspective.

Mr. **Jones** of Tennessee. This chairman hopes you will not have to do that because with all the problems that the farmers have out there today I would hate to see this added problem on their backs in 1987.

Mr. Coleman, you are recognized.

Mr. **Coleman**. Gentlemen, you have presented us with a fairly optimistic viewpoint as far as meeting the credit needs of farmers, and I feel it is overly optimistic but I hope you are right.

Is it true that half of the $28 billion the farmers were loaned is in jeopardy of default?

Mr. **Naylor**. The General Accounting report correctly identifies these as problem loans; that volume of problem loans exists within the agency. We don't know whether anywhere near that volume of loans will default. I do not think that will be the case. By and large these are disaster loans; by and large they are in the Southeast.

Mr. **Coleman**. You mentioned the loans are disaster loans and, indeed, there was a disaster, and I suggest you ought to go back and look at some of the disaster loans which were followed by further disasters and the farmers had no chance of paying off the disaster loans. In some cases that is the reason they have not been paid back, and I think that now we have left them pretty high and dry in the farm bill. So I just would not suggest because you had a large default ratio there that it necessarily was a bad program. It simply was a repetitious disaster in many cases in my part of the country. Where you have no income, you cannot pay off a previous loan. It does not matter what you do or how good a farmer you were.

Two points before I close. I was wondering if you all had put together any sort of proposal or regulations regarding the inventory property management which I hope will be coming under scrutiny and change as a result of the farm bill and allow that to be open bids and emphasis on priority on the small operation and management companies.

Mr. Clark, will you promulgate regulations in that area? What can you tell us about it?

Mr. **Clark**. Yes; we are thinking about that. We have not got down to regulation writing. We are very aware of the contents of the Food Security Act, and we are really going on what the Food Security Act dictates. What the Food Security Act dictates is not much more different than what we are doing. We will hold that property off the market. We will not depress the land values around us by putting that property on the market. I think we are very careful about that.

As you know, conservation issues are also involved. We have to work with SCS to put together a conservation plan; and we agree with you. In Missouri we did have an outside management firm that was awarded on a bid basis. I think we are aware of that problem as well, trying to polish, I think, that program, with interest in going, obviously, as the bill mandates, to the small businessmen in the community to manage, and so we are aware of this and working in that direction.

Mr. **Coleman**. Of course, the intent was to not put the whole State in one basket, but to allow local people to have the opportunity to bid not just for it in that area—I mean in that area, not necessarily all over the State or wherever it might be.

Mr. **Clark**. That is correct.

Mr. **Coleman**. Another thing is we have seen and you have seen, Frank, maybe Mr. Clark did not have a chance to see, is when we have debt restructuring or forgiveness.

Mr. **Naylor**. Yes; that is one option we have.

Mr. **Coleman**. When you foreclose—you have to foreclose on some people—that there is an attached code inequity which results in actually a farmer who has been foreclosed on or who has been given part of his loan forgiven, the farmer has tax consequences. Even though he may be penniless, he still owes either a capital gains or ordinary income tax on the basis of these transactions. I think in a lot of circumstances this is very unfair and these people have not been able to wipe the slate clean. They end up owing Uncle Sam money.

Have you seen that phenomenon?

Mr. **Naylor**. It does occur, not so much with ourselves but with some of the commercial lenders or the land banks particularly. There has been a good deal of discussion within Congress and even within the administration whether some adjustment can either be done by regulation or by legislation if required. I am not, frankly, aware, Mr. Coleman, of any specific action that has been brought forward at this time.

Mr. **Coleman**. I would only ask you to lend your good offices to support efforts that several of us have introduced legislation here to try to accomplish and wipe out this inequity in some circumstances and to join with us in that and to have your voices heard in the administration because you had firsthand knowledge and experience in this area.

And it seems to me it is a fairness issue and one where I would hope we could show compassion and concern and that you could support us in that effort to try to help the farmers not end up owing Uncle Sam. It is very ironic after they lose the family farm they then owe the Government and they do not have any money.

Thank you. Will you do so?

Mr. **Naylor**. Yes. We will be delighted to work with you and review yours and other proposals, and we do intend to continue to work with the Treasury Department on the question.

Mr. **Coleman**. Thank you.

Mr. **Jones** of Tennessee. Thank you, Mr. Coleman.

I do also want to associate myself with the remarks that Mr. Coleman has made, especially those that have something to do with the feeling that we have received from you gentlemen today that there is credit out there for 1986 and you will be able to timely take care of the situation as the needs arise. I can say to you, Frank, and I would like to say this to Mr. Clark—Mr. Naylor already knows, I am sure, that this subcommittee is interested in what goes on. We are going to cooperate in every way we possibly can. We have seen just about all the good farmers leave the land that we want to see leave, because we feel like we are getting down to the point now that we need to start saving some of them.

Mr. Naylor, previously you mentioned that you get on a daily basis a Farmers Home lending report from the various States. Is that not right?

Mr. **Naylor**. Yes, we get a daily summary of the funds that we are obligated for officially at our St. Louis office, and that is broken out also by State.

Mr. **Jones** of Tennessee. Amount of funds remaining in the——

Mr. **Naylor**. Yes, by quarterly allocation, amount proportioned by OMB in that report. That is the way it is prepared.

Mr. **Jones** of Tennessee. It also contains a comparison of the activity you had a year ago?

Mr. **Naylor**. Yes, it does.

Mr. **Jones** of Tennessee. Would you provide this subcommittee, say on a Friday, whenever your week is over, with those statistics so we know what is going on?

Mr. **Naylor**. Yes. We had a somewhat similar report last year, Mr. Chairman. If you would like to reinstitute that data, we would be pleased to do so.

Mr. **Jones** of Tennessee. Could that be done on a weekly basis without too much difficulty?

Mr. **Naylor**. We can arrange for it to be done, yes.

Mr. **Jones** of Tennessee. I think it would be very helpful.

Don't you, Tom?

Mr. **Coleman**. Yes.

Mr. **Jones** of Tennessee. I really believe that this would be quite helpful.

And if there is no objection, we would certainly appreciate your doing that.

Mr. **Naylor**. We would be delighted to cooperate, Mr. Chairman, and we will work with your staff to arrange for the appropriate transmittal.

Mr. **Jones** of Tennessee. You have done a good job and I congratulate you, and I just remark, as I said earlier, we look forward to doing the same thing with you as we have previously.

Mr. **Naylor**. Thank you.

Mr. **Jones** of Tennessee. I would like without objection to leave the record open a little while after we recess and before we adjourn for any questioning or any submissions that any other members of the subcommittee might have.

Mr. **Coleman**. If the chairman would allow me just to ask, I guess Mr. Naylor, if he has had a chance to review the bank proposal from the ABA, IBAA, and does he have any comments on that?

Mr. **Naylor**. Mr. Coleman, briefly, it is probably a little early for me to comment. The administration has generally taken the position that what we have loosely termed capital certificates is something with which we find considerable trouble. We would find it difficult to support and would almost certainly have some objection concerning them. The guarantee program, where it deals with regulatory issues, is one that we are prepared to support and look forward to working with the commercial banks on. I would not expect us to request any change through our authorizations and, obviously, that would raise issues for you and others as to where the offset would be if that authorization level were to be affected because the Gramm-Rudman adjustment would have to be made.

With regard to the secondary market, we are working very closely with the ABA on what, I think, is a particularly attractive tool for them to use. Hopefully we can see them develop a secondary market, and I should include the independent banks acting in that effort also. This would make the program much more usable to the banks. We do not need in our view legislation to accomplish this, but we do need some cooperation and efforts with the securities industry to see that accomplished promptly. We have used it in our commercial loan area with great success, and we are very enthusiastic about developing it as an additional incentive for the banks to use this program.

Mr. COLEMAN. Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman, and thank you, Mr. Naylor and Mr. Clark, and I want to take this opportunity to thank the audience that has been so cooperative, and we appreciate the fact that you are concerned and interested in the subject we have been having the hearing on.

With that, the subcommittee does stand adjourned until the call of the Chair.

[Whereupon, at 3:55 p.m., the subcommittee adjourned, subject to the call of the Chair.]

[Material submitted for inclusion in the record follows:]

REMARKS OF
VANCE L. CLARK
ADMINISTRATOR
FARMERS HOME ADMINISTRATION
UNITED STATES DEPARTMENT OF AGRICULTURE
Before the
SUBCOMMITEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT
HOUSE COMMITTEE ON AGRICULTURE
February 6, 1986

Mr. Chairman, Members of the Committee, I appreciate this opportunity to discuss the Farmers Home Administration's (FmHA) servicing regulations and notices to farm borrowers who are seriously behind in loan payments, and other subjects in which you have expressed an interest.

A brief background may be helpful for a complete understanding of FmHA's loan and loan-servicing goals and procedures.

For many years the Farmers Home Administration has been helping its farm borrowers who found themselves in economic trouble through no fault of their own. The agency routinely helped these farmers, when possible, through rescheduling or reamortizing loans and, in some cases, deferring part of their payments. The direction to the field to provide this assistance came from the national office through regulations and Administrative Notices.

In November 1983, in a class action affecting all but six states, the Federal District Court in Bismarck, North Dakota, issued a preliminary injunction, that later became permanent, which required Farmers Home to take additional procedural steps to inform borrowers of the loan servicing alternatives available to them before acceleration of debt and possible foreclosure. Other District Courts had imposed the same type of requirements on the agency.

On November 30 1984, the agency issued a proposed rule to comply with the court ruling and to administratively change the way it serviced its farm loans. Following the comment period and necessary adjustments, the regulations were issued as a final rule on November 1, 1985. The regulations, encompassing 63 pages of the Federal Register, covered all options and procedures in detail. Certainly, the agency made every effort to comply with the courts' mandate to assure due process for every FmHA borrower.

The loan-servicing options are clearly spelled out to all FmHA farm borrowers who were delinquent as of December 31, 1985, and those otherwise in default. That date was selected because it is historically the lowest delinquency point of the year. Most of the loan agreements call for an annual payment which is due on or about January 1. So most borrowers are at least one year delinquent before being advised of the status of their account.

The intent of a notice is to alert the farmer that he or she is in default and to spell out the various options available.

These options include:

- Rescheduling or reamortizing at regular rates and terms;
- Rescheduling of operating and farm ownership loans at limited resource rates and terms;
- Deferral of payments on principal or interest or both for 5 years, if qualified;
- Subordination of FmHA's security position to another lender;
- Restructuring by selling a portion of assets;
- Paying the account current; and
- Liquidating the account by selling, conveying to the Government or transferring the security, or refinancing with another lender.

Eligibility for these options is spelled out in detail in the regulations. For example, in order to be eligible for a deferral on loan payments, a borrower must show such things as the reasons for needing the deferral are due to circumstances beyond the borrower's control and the need for the deferral is temporary. FmHA, in turn, must find, among other things, that the borrower had made a good faith effort to meet agreements made with FmHA and that, with the deferral, the borrower can eventually repay the loan or loans.

All FmHA borrowers who have made no payments on one or more loans for three or more years as of December 31, 1985, or who have failed to properly account for security, or who have abandoned the farming operation will be sent a notice of "Intent to Take Adverse Action." It will cite the specific problem with the borrower's account and require the borrower to respond within 30 days.

When the borrower's response is received, an appointment is set up to review the borrower's financial condition. If one of the servicing options is approved, the notice to take adverse action is terminated. If the borrower fails to respond within 30 days or the servicing options cannot restructure the debt, FmHA will proceed to collect the account. Failure to respond within 30 days also forfeits any appeal rights.

Borrowers who are not in the above category will receive a letter requesting them to contact the county office within 30 days to make an appointment to try to work out their loan problems. The same list of servicing options will be sent to them. These borrowers will not receive a notice of "Intent to Take Adverse Action" at this time.

The idea is to have the farmer and the FmHA county supervisor sit down together and, if possible, develop a workout plan that yields a payment schedule that can be handled within the farmer's cash flow.

In addition to the options in the FmHA regulations, the Farm Bill contains a number of provisions that are presently being analyzed. They include the softwood timber section, conservation easements, and the homestead provisions. Let me say here, Mr. Chairman, that we have made good progress in preparing the regulations needed to implement the credit provisions of the Farm Bill. More than 30 individual regulations are involved, and our current goal is to publish them in the Federal Register as soon as possible after the necessary clearances are obtained. I would like to see that done by March 1.

But, back to servicing; only after every option has been tried without success will there be any move toward additional action as prescribed in the regulations. Even then, the borrower has a right to appeal FmHA's decisions to assure that all possible options have been examined.

It is expected, that with all the options and assistance available to FmHA borrowers, some will be able to work out of their financial difficulties. There are those who are so far behind or have a debt structure that no amount of assistance can help. Of course, we cannot estimate the number of farmers that will be in that category until we have made every effort to help them work out a reasonable solution to their problems.

Mr. Chairman, this FmHA forbearance policy offers borrowers much more assistance than the policy of any other lending institution that I am aware of. The 5-year deferral option alone offers more relief to borrowers than typical state moratoriums which, at best, prohibit foreclosure by private lenders for a year if the borrower can make interest payments.

The Farmers Home Administration is making every possible effort to assist its seriously delinquent farmers under its authorities. Predictions by some of massive foreclosures under these regulations are unwarranted in my view.

We believe we are making a fair, reasonable and equitable attempt to provide every possible assistance to farmers who are behind in paying their debts to the government while, at the same time, carrying out our responsibilities to the Nation's taxpayers.

Mr. Chairman, you asked about the impact of the Gramm-Rudman-Hollings deficit reduction process on Farmers Home activities. For the current fiscal year, we anticipate being able to provide the essential services mandated by the Congress. Under terms of the legislation, however, we have no recourse but to reduce the amount available for the various loan programs -- if the process runs its course to the March deadline. The direct loan programs will be reduced by the necessary 4.3 percent. By curtailing some planned expenditures such as for supplies and telecommunications and by making adjustments in other activities such as training and travel, we believe we can avoid staff reductions in the crucial spring lending season.

Section 1312 of the Farm Bill authorizes the use of the Agricultural Credit Insurance Fund in timely processing of loan and loan guarantee applications. It may become necessary to do that, depending on the loan demand that develops. We would have to keep in mind, however, that Gramm-Rudman-Hollings requires that adjustments necessary to meet the ceilings be made somewhere along the line.

Another subject you asked about is a proposed regulation that would allow the FmHA Administrator to limit loans for the production of farm commodities that are in surplus. That proposal was published in the Federal Register on December 2, and the comment period expired last week.

The intent of that proposal was simply to prevent further financing of commodities already in surplus and, thus, adversely affecting the existing market for those items, and to prevent inefficient use of limited Government funds. I am confident that, after the public comments have been analyzed, the language will be re-examined. Where appropriate, it will be changed.

At this point, Mr. Chairman, I'll try to answer any questions you or other Members of the Committee may have.

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February 5, 1986

Hon. Ed Jones
House Agriculture Committee
108 Cannon House Office Bldg.
Washington, D.C. 20515

Dear Representative Jones:

Enclosed are recommendations on agricultural credit, developed by a joint task force of the American Bankers Association and the Independent Bankers Association of America. We deeply appreciate your interest in the very serious agricultural credit problems, and we hope that these joint recommendations will be useful in finding solutions to these problems.

Sincerely,

Bud Gerhart

Bud Gerhart, Chairman
Agriculture-Rural Committee
Independent Bankers Association
of America

Randall Killebrew

Randall Killebrew
Vice Chairman
Government Relations Council
American Bankers Association

(Attachment follows:)

RECOMMENDATIONS OF THE ABA-IBAA TASK FORCE ON AGRICULTURAL CREDIT

February 4, 1986

The banking industry considers it essential that steps be taken early in 1986 to assist commercial banks and their agricultural borrowers in coping with the accumulation of problem farm debt. The IBAA and ABA met jointly in Dallas, Texas, on January 15-16 and, based on that meeting, will seek measures that can help to stabilize the capital structure of agricultural banks and to assist individual agricultural borrowers in managing their debt during this critical period. Recognizing that agricultural banking can return to profitability only when the agricultural economy is again profitable, the fundamental premise of these proposed measures is that agriculture is experiencing massive change and bankers and their agricultural borrowers need a reasonable period of time to adapt.

We will seek to implement such measures through regulatory action to the extent that they can be carried out under existing law, and we will seek legislation where existing law is inadequate. Our Associations will pursue a plan of action involving three main elements: (1) stabilization of bank capital; (2) stabilization of agricultural borrowers; and (3) stabilization of farm real estate values.

Stabilization of Bank Capital

The most immediate problem confronting agricultural banks is the impact on bank capital of sudden and massive agricultural loan losses. In 1984, agricultural production loan losses charged off by commercial banks totalled $900 million--an increase from $436 million in 1983. Such charge-offs for the first two quarters of 1985 were $520 million, almost double the $280 million charged off in the first two quarters of 1984.

These extraordinary charge-offs are eroding the capital structure of many agricultural banks as the loan losses are deducted from the banks' available capital. As a bank's capital is reduced, both the total capacity of the bank to extend credit and the size of individual loans that the bank can make are correspondingly reduced. If a bank's capital falls below the minimum required by the regulatory agencies, the bank is subject to enforcement actions which may lead to closure.

"The Farm Credit Act Amendments of 1985" (PL 99-205), signed by the President on December 23, 1985, was Congress' response to a similar problem in the Farm Credit System. Faced with mounting agricultural loan losses, the Farm Credit System requested Federal backing to guarantee its continued access to capital in the credit market. Congress and the Administration responded to the Farm Credit System's request for assistance with PL 99-205.

To keep agricultural banks open and to maintain their capacity to extend credit to borrowers, we recommend that special measures be implemented to preserve the capital structure of agricultural banks. Agricultural banks traditionally have been well capitalized, but the persistent downturn in the farm economy since 1981 is severely pressuring the capital structure of hundreds of agricultural banks. The farm economy will recover in time, providing a basis for greater earnings and replenishment of the capital structure of agricultural banks. In the meantime, we need special measures to prevent banks' capital from being precipitously eroded by requirements that banks offset problem farm loan assets whose market value has been reduced.

Our first priority as a means of preserving banks' capital is to change regulatory accounting procedures and enable prudently managed banks to amortize their loan losses over a multi-year period. Such a procedure is relatively simple to administer, would assist a broad segment of banks and their borrowers, and would entail no direct government cost.

Two other options that warrant consideration as ways to assist banks in maintaining adequate capital during this stressed period in agriculture are:

- regulator-assisted injections of capital into certain troubled banks. (For example, a qualifying agricultural bank might acquire additional capital from the Federal Deposit Insurance Corporation in the form of debt or equity.);
- unfunded capital certificates similar to net worth or income capital certificates currently used for certain thrift institutions.

Because of the potential direct impact on bank's capital, we shall also focus careful attention on proposed changes to the Internal Revenue Code. For example, banks can currently carry net operating losses back ten years and obtain refunds for taxes paid in those years, thereby increasing capital. Proposed tax reform legislation would change the carryback period to three years and any excess losses would be carried forward. If this change were to become law, agricultural banks now incurring net operating losses would lose some of their ability to maintain an adequate level of capital.

We will work with the Administration, the bank regulatory agencies, and the Congress to obtain action early this year to relieve pressure on agricultural banks' capital structure.

Stabilization of Agricultural Borrowers

While we need action early this year to stem the erosion of agricultural banks' capital accounts, we also need stabilization of agricultural borrowers' debt situations and ability to cash flow their debt. For that purpose, we recommend further expansion of the Farmers Home Administration (FmHA) agricultural loan guarantee programs and authority. In the current budgetary situation, the FmHA loan guarantee program is the least costly means of stabilizing and extending agricultural debt. In addition, expansion of the $490 million interest rate buy-down program included in the 1985 Farm Bill would provide major cash flow assistance to agricultural borrowers at minimal direct cost. We also need clarification this year of the FmHA's preparedness to provide direct loans to qualifying farmers who cannot be financed in full by commercial lenders.

Stabilization of Farm Real Estate Values

We seek the development of an institutional secondary market for longer term real estate loans originated by commercial banks. A secondary market would provide access to additional funds and diversify the risks and returns from farm lending. One option is to pool FmHA-guaranteed loans for resale as mortgage-backed securities to investors.

Proposals for warehousing of problem agricultural loans and/or acquired assets also merit continued examination. Permitting banks to hold real estate assets for a longer period of time also merits consideration. Stabilizing land values is necessary to restoring health to the agricultural economy.

86-524 ENR

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THE FARMERS HOME ADMINISTRATION'S NEW REGULATIONS FOR HANDLING DELINQUENT FARM BORROWERS: BACKGROUND AND CURRENT POLICY ISSUES

Jean M. Rawson
Analyst
Environment and Natural Resources Policy Division
January 23, 1986

ABSTRACT

On November 1, 1985, the U.S. Department of Agriculture's Farmers Home Administration (FmHA) published regulations instituting new procedures for handling farm loan program borrowers who are one year or more delinquent in their loan payments. This report outlines the history of the lawsuit that led to the promulgation of the new regulations, examines the arguments against them contained in the subsequent legal challenge, and discusses some of the policy issues underlying FmHA's actions regarding delinquent borrowers.

THE FARMERS HOME ADMINISTRATION'S NEW REGULATIONS FOR HANDLING DELINQUENT FARM BORROWERS: BACKGROUND AND CURRENT POLICY ISSUES

INTRODUCTION

Under regulations published November 1, 1985, in the Federal Register, about 25 percent of all Farmers Home Administration (FmHA) farm loan program borrowers (roughly 70,000, as estimated by FmHA) could each receive a "Notice of Intent to Take Adverse Action" and a packet of information on loan servicing options in late January and early February if they were one year or more delinquent and at least $100 in arrears on loan repayment. The receipt of these notices would set in motion a scheduled sequence of borrower responses, meetings between FmHA loan supervisors and delinquent borrowers, and choices of workout options and drawing up of yearly farm and home plans, with certain appeal rights available to the borrower as the timetable progresses. In cases where options would fail to make an operation financially viable or the borrower fails to respond in accordance with the new regulations, FmHA could proceed with foreclosure. At least on paper, these new regulations indicate that FmHA would pursue a tougher course of action with its delinquent borrowers than in the past.

This report briefly describes FmHA farm loan programs and delinquency levels, examines how the new regulations came about, outlines the arguments against them as stated in subsequent legal action, and summarizes some of policy issues underlying FmHA's actions regarding delinquent borrowers.

BACKGROUND

As an agency of the U.S. Department of Agriculture (USDA), FmHA has several programs through which it provides loans to farmers who are unable to qualify for credit at private lending institutions. The three most heavily used farm loan programs are the farm ownership program (long-term loans for the purchase or improvement of farms, or the refinancing of farm real estate); the operating loan program (short-term loans for the purchase of seed, feed, fertilizer, livestock or other production supplies); and the emergency disaster loan program (to help recover from losses due to floods, hail, drought, etc.). Direct loans to farmers under the farm ownership and operating loan programs increased by almost two-thirds in FY85 -- from $2.6 billion in FY84 to $4.3 billion. Record lending levels under the emergency disaster loan program in 1978 and 1980, and under an economic emergency loan program from 1978-1981 and in 1984 (now terminated), have also contributed to the current high rate of repayment delinquency. FmHA also guarantees short- and long-term loans made to farmers by private lending institutions; however, the policy issues surrounding guaranteed loans are not within the scope of this paper. (For more information on FmHA's farm loan programs, lending levels, and other policy issues, see the CRS issue brief IB86004, Farmers Home Administration: Farm Credit Policies and Issues.)

The highest FmHA loan delinquency levels are in the southeastern, south central, and southwestern United States; large loans under the emergency disaster and economic emergency loan programs are largely responsible for this concentration. Without those loans, the distribution of delinquency would show a concentration of problem borrowers in the Corn Belt, the Lake States and Northern States more in keeping with the acknowledged economic stress in those areas.

LEGAL HISTORY OF THE NEW REGULATIONS

The new regulations concerning supervision of delinquent borrowers in FmHA farm loan programs are the Government's response to a ruling made in November 1983 by U.S. District Court Judge Bruce Van Sickle in a national class action suit entitled *Coleman* v. *Block*. This case paralleled several statewide class action suits, most notably *Curry* v. *Block* in Georgia, which was the first suit brought for the purpose of forcing USDA to implement a 1978 statute allowing borrowers to defer FmHA loan payments for 5 years if adverse economic or weather conditions made repayment impossible.

The judge's order in the *Coleman* suit, which was issued one year after *Curry*, required that before FmHA could foreclose on delinquent borrowers it had to (1) give borrowers notice of its intention to terminate planned releases of normal income for family living or operating expenses and provide for an appeal hearing before termination; (2) notify borrowers of the standards they would need to meet to receive a deferral and provide for a hearing if a deferral were not granted; and (3) give borrowers a written explanation of the decision the agency made as a result of any hearing. Judge Van Sickle's ruling covered all States except those where similar rulings were already in effect: Alabama, Florida, Georgia, Kansas, Minnesota and Mississippi.

The *Coleman* decision did not require USDA to promulgate formal regulations to carry out Judge Van Sickle's orders, and there was no provision for either the judge or the counsel for the plaintiff to review any regulations that FmHA might create. However, on December 20, 1983, FmHA sent to its field offices an internal document called the pretermination package, which (1) halted foreclosures in progress at the time; (2) reinstated releases of normal income for family living or farm operating expenses; (3) postponed farmers' conveying any property to FmHA to discharge their indebtedness; and (4) reversed all decisions to call in (accelerate) delinquent FmHA loans. The pretermination package also outlined all the steps that local FmHA offices were to take to manage their current loans, including granting of deferrals.

In October 1984, FmHA suspended the pretermination package, but said it would not proceed with any foreclosures until formal regulations were published. In November 1984, preliminary regulations were published in the *Federal Register* for interested parties to comment upon. On Nov. 1, 1985, the final regulations were published and became effective after having been amended to reflect some of the comments received.

It should be noted that the farm interest groups that responded to the draft regulations were primarily "grassroots" organizations active at the local level in several States. National organizations, such as the National Grange, the American Farm Bureau Federation, and the National Farmers Union, did not submit comments when the draft regulations were published in 1984. There currently are indications of a considerable variance of opinion among national farm interest groups over the new regulations.

The plaintiffs in the supplemental complaint are the same as in the original *Coleman* v. *Block* class action suit. They filed the complaint at the end of November 1985; in early December they also filed for an injunction to stop FmHA's proceeding under the new regulations. On January 23, Judge Van Sickle will hold a hearing on the complaint. The testimony will be weighed in his decision whether to accept the complaint and impose an injunction. It is not known how soon he will make a decision.

LIKELY POINTS OF CONFLICT 1/

Release of Income for Living and Operating Expenses

One key document in an FmHA loan is the yearly farm and home plan, which is worked out between the borrower and the FmHA county supervisor. The plan spells out how the loan funds are to be used, and establishes how much of the income from a sale of secured property (for example, cattle or grain) is to be used to make a loan payment, and how much is to be "released" to cover other expenses. Under the old regulations, FmHA was required to plan that the first priority for income release would be for living and farm operating expenses, not FmHA loan repayment or other debt payments due. The new regulations stipulate that priorities are to be determined by the borrower and supervisor during the farm and home planning process; there is no automatic first priority given to living and operating expenses.

The Center for Rural Affairs 2/, one of the primary farm interest groups concerned with FmHA's supervision of delinquent farm borrowers, is concerned that this exposes borrowers' living expense needs to the whims of local FmHA supervisors. Conversely, one State FmHA official believes that the new procedures will make it very clear to borrowers, right from the start of the year, how much income will have to go toward repaying FmHA and how much will be available for living and farm operating expenses. If a plan cannot be worked out to maintain a viable operation, and cover loan repayment plus

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1/ A copy of the supplemental class action complaint is on file with the author of this report; it is available for review by calling the analyst.

2/ The Center for Rural Affairs, formed in 1973, is a private nonprofit corporation involved in public policy issues affecting family farms and rural communities.

family expenses, then FmHA can proceed with calling in the loan.

The borrower has certain rights of appeal in the acceleration process, although the Center for Rural Affairs' opinion is that the appeal rights are insufficient. The recent complaint filed by the plaintiffs also claims that borrowers do not have sufficient control over the availability of funds for living and operating expenses, that the notification process if release of income is denied is inadequate, and that the borrower has no hearing, review or appeal rights in the event of denial.

The credit title of the Food Security Act of 1985 (P.L.99-198, Sec. 1315) provides that FmHA must release sufficient income for living and operating expenses until such time as the loan is accelerated. This language could be interpreted to support the plaintiff's claim against the new regulations with regard to income releases. However, it is still unclear how Congress intended FmHA to act in the case of delinquent borrowers. FmHA is in the process of writing new regulations implementing the credit provisions of the farm bill. They expect to publish these rules in the Federal Register in early February, at which time it may become clearer how the agency plans to interpret Congress' intent on this issue.

Eligibility for Deferral

Deferral is a loan servicing option that permits borrowers to defer payment of principal and interest, interest-free, for a certain length of time. The new regulations set three conditions for eligibility for loan deferral. First, the borrowers must have attempted voluntary debt adjustment with local suppliers of machinery, seed, etc., before they will be considered for deferral. The plaintiffs claim that this condition is inconsistent with the intent of the judge's orders in the original case--

i.e., to make deferral available as a loan servicing option. The Center for Rural Affairs concurs that the survival of farm supply firms is critical to the health of farm communities, and to force these generally unsecured creditors to take a loss before a borrower can receive a deferral is unfairly damaging to these businesses.

The second condition for deferral eligibility is that the borrowers must be current in their real estate tax and insurance payments. The plaintiffs claim that such payments are frequently overdue because FmHA has not released, or has delayed releasing, farm income with which to make the payments.

The third condition is that borrowers be able to demonstrate that they have operated the farm using "recognized successful production and financial management practices." However, what constitutes acceptable practices is not spelled out in the regulations. In the opinion of the plaintiffs and the Center for Rural Affairs, this places too much subjective judgment in the hands of the FmHA county supervisor for determining loan deferral eligibility.

Concurrent Acceleration of All Loans

The third area of controversy concerns the new provision that requires chattel (machinery and livestock) and real estate loans to be accelerated at the same time if either loan is in default. FmHA says the reason both loans need to be called in is that accelerating one loan could jeopardize the borrower's ability to continue operating and thus maintain payments on the other. The argument made against this provision is that acceleration of one bad loan could jeopardize another loan that supports a viable operation. For example, an operating loan that is current could be supporting a viable farming operation, while the borrower is unable to meet payments on his real estate loan. The new provision, it is argued, allows FmHA to accelerate both loans and thereby to jeopardize the ability of the farmer to continue operating at all.

The recently filed complaint states that the new regulations do not contain any formal standards to determine that default on one loan would in fact jeopardize another, and that the borrower has insufficient rights of appeal.

Other Issues in the Supplemental Complaint

Another area of controversy concerns the new acceleration and adverse action documents that will be sent to borrowers. The plaintiffs claim multiple problems with clarity, accuracy, completeness and tone in the letters and forms.

The plaintiffs also claim that FmHA included several changes in the final regulations were never published in proposed form in the *Federal Register* for public comment.

The last controversial provision concerns the starting date for deferral eligibility under the new regulations. The regulations would seem to indicate that borrowers declared delinquent prior to October 20, 1984 are not now eligible for deferral. However, a telephone interview with a USDA FmHA official revealed that *all* delinquent borrowers--regardless of the length of delinquency--will receive the same notice and thus will be able to choose deferral as their loan servicing option if they wish. At this time it is unclear if a long-delinquent borrower who checks off deferral as his option choice on the form that he mails back to FmHA will, in fact, be able to use that option when he meets with the county supervisor to draw up a new farm and home plan.

If these long-delinquent borrowers are denied deferral, FmHA is likely to state as a reason that such borrowers have had a de facto deferral since late 1983, when FmHA froze action on foreclosures and accelerations. According to this reasoning, if such borrowers have not been able to improve their financial viability in the intervening 2 years, then a further deferral is probably not going to help them.

OTHER ISSUES RELATED TO THE NEW REGULATIONS

The volume of loans that will need servicing as a result of the new regulations could potentially overwhelm FmHA's personnel, which even last year needed assistance from volunteers and other local USDA offices to handle the borrowers who applied for spring operating loans under special credit initiatives. Observers such as the Center for Rural Affairs fear that personnel may make decisions too quickly in order to keep up with the workload.

Servicing loans under the new regulations will coincide with the period that farmers generally come in to apply for their operating loans for spring. It is also expected that Production Credit Associations, Federal Land Banks and commercial banks will choose not to continue lending to financially shaky borrowers in an effort to remain viable themselves. Many of these people are likely to apply to FmHA for credit. At the minimum, use of overtime and transfer of personnel from less busy areas to busier ones will be necessary to handle the likely surge in workload.

Another issue that is likely to surface soon is a change in FmHA's criteria for granting additional credit. Beginning in February 1982, FmHA disregarded borrowers' ability to repay prior loans when they applied for additional financing. This was an effort to help farmers cope with the worsening economic conditions, and became known as the continuation policy. The new regulations terminate the continuation policy, and require borrowers to be current on previous loans before new credit can be extended.

CONCLUSION

The FmHA loan issues facing Congress are mirrored in the lack of consensus among farm groups over the new regulations. The controversy centers over the balance that needs to be struck between FmHA's role as the lender of last resort and its responsibility to protect the taxpayer's financial interests. To what degree should FmHA "get tough" with its borrowers and begin to operate more as commercial financial institutions do in evaluating creditworthiness and servicing loans? Or is its role as the lender of last resort more important at this time of economic adjustment in the farm sector? Does FmHA have a role to fulfill a social objective in stabilizing rural areas hard hit by agricultural depression? How much of the FmHA loan portfolio is at risk of never being repaid? How much of that loss is the Government willing to absorb? These are some of the policy questions that will underlie the congressional debate in the next few weeks.

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OVERVIEW OF THE NUMBER OF FARMERS GOING OUT OF BUSINESS

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ABSTRACT

This report analyzes the available data on farmers going out of business, with particular emphasis on the data showing the numbers leaving for financial reasons. Farm failure rates of borrowers at commercial agricultural banks, Farm Credit System banks and institutions, and the U.S. Department of Agriculture's Farmers Home Administration are examined. The report also discusses how changes in the farm and national economies might affect future trends in the farm failure rate, as well as the policy implications of possible increases in the rate of farmers going out of business.

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OVERVIEW OF THE NUMBER OF FARMERS GOING OUT OF BUSINESS

THE BIG PICTURE

The rate of farm failures in the past four years has been higher than normal, reflecting the continuing decline in producers' income and net worth.

Historical data show that, through the 1970s, about one-tenth of one percent (0.001 percent) of all agricultural producers annually went out of business due to foreclosure action by lenders, and due to borrowers' decisions to file for bankruptcy. It is important, therefore, in analyzing the current situation to keep in mind that the increase in the incidence of farm failures is up from a level that is normally quite low.

Data on farm numbers, collected by the U.S. Department of Agriculture (USDA), show that there were 2.328 million farms on June 1, 1984 (see table 1). This is a decline of about 42,000 farms, or 1.76 percent, from mid-1983. USDA has estimated that there were roughly 43,770 fewer farms on June 1, 1985, compared to a year earlier--a 1.9 percent decline from 1984. Overall, over the last 5 years, the number of farms has declined from 2.433 million in 1980 to 2.285 million in 1985, or 6 percent. These aggregate figures represent farms that went out of business for nonfinancial reasons (i.e., retirement, death) as well as for financial reasons, but also include new entrants into agriculture.

The decline in the number of farms does not correspond to a similar decline in acres being farmed. There were 1.019 billion acres of land in farms as of June 1, 1984, down 4.8 million acres, or .5 percent, from 1983. For 1985, USDA estimates a decrease of 4.0 million acres in farms, or .4 percent, from 1984. Since 1980, land in farms has declined from 1.04 billion acres to 1.02 billion acres, or 2.2 percent.

Available data on the number of producers going out of business seem to point to a slightly higher rate of farm failures in 1985 than in 1984. This rate might have been even higher, had not many agricultural lenders adopted policies to work closely with borrowers to refinance and restructure debts so that they could continue operating. Also, more producers than usual took steps to partially liquidate some of their assets in order to stay in business. Nevertheless, the rate of farm failures in 1984 and 1985 is above the historical low levels of the 1970s, which reflected a relatively prosperous period in farming.

Access to credit provided by USDA's Farmers Home Administration (FmHA), the Federal Government's lender of last resort to agricultural producers, also contributed to fewer farmers being forced or having to decide to go out of business. Many borrowers no longer able to meet the credit standards of Farm Credit System (FCS) institutions and commercial banks have been able to qualify for FmHA loans.

INFORMATION ON FARMERS GOING OUT OF BUSINESS

Lingering economic problems in the farm sector are prompting increasing numbers of reports on and analyses of the financial conditions of agricultural borrowers and lenders. However, complete and definitive data on the number of farmers going out of business for financial reasons is not available, and certain useful categories of data that once were collected have been discontinued. For example, the private, cooperatively owned banks and associations of the Farm Credit System once collected data on the number of loan applications they denied because applicants failed to meet credit standards. This was discontinued toward the end of 1984. A USDA data series that estimated the number of foreclosures occurring each year was discontinued after 1981. The U.S. Department of Commerce used to publish the number of farm bankruptcies nationwide, but discontinued the practice when the Administrative Office of the U.S. Courts began grouping farm bankruptcies with those filed by all other businesses. Official reasons often cited for discontinuance of data series are that the information was frequently misinterpreted, that (in FCS's case) competing lenders used the information for their own benefit, or that the role of the agency collecting the data had changed and such information was no longer within its purview.

Among all possible data sources, the USDA's Farmers Home Administration (FmHA) provides the most complete information on its borrowers who go out of business. The Farm Credit Administration, partly in response to its expected reorganization into more of a regulatory agency over the Farm Credit System than before, has begun to collect data on the financial condition of FCS institutions rather than on FCS borrowers. The commercial agricultural banks and Federal Reserve System

Banks are traditionally the most conservative in the type of financial and borrower information they will release. Polls of bankers taken by the American Bankers Association and some of the Federal Reserve Bank districts give the percentages of farmers going out of business in their banking areas, but no actual figures. At best, these surveys are useful as indications of whether the economic trend in farming is worsening or improving.

This overview of recent farm failures is based on surveys and reports prepared by the American Bankers Association, five District Federal Reserve Banks, the Farm Credit Administration, and USDA's Farmers Home Administration and Economic Research Service.

DEFINITIONS OF FARM FAILURES

Farmers go out of business in a number of different ways. A liquidation involves the sale of farmland and/or equipment. A voluntary liquidation is usually initiated by a farmer who recognizes that he cannot continue his operation on an economically sound basis, and decides to sell his farm assets in order to repay existing debts and, if possible, be left with some equity. Deteriorating financial circumstances may also prompt some farmers to retire earlier than planned. An involuntary (forced) liquidation usually occurs when a lender decides not to extend additional credit to cover another year's production expenses and the producer is unable to find an alternative source of financing. If a producer cannot sell some of his assets to generate some income and to repay some farm debt, and still be able to continue operating, he is in most instances forced to sell his entire operation.

Farmers can also file for bankruptcy in order to wipe out their debts. A farmer who files under Chapter 7 works with a trustee appointed by a bankruptcy court and his creditors to divide the farm's assets among the creditors and thus clear himself of any obligations on remaining debt. Filing under Chapter 7 usually results in the farmer's going out of business, and is generally done by those whose liabilities are greater than the assets they own and who have a negative cash flow. Farmers filing under Chapter 11 may use a prescribed time period to reorganize their farm in order to operate it on a financially sound basis. These operators generally are in salvageable financial condition, and usually remain in business. Farmers who meet certain debt limit requirements may file for bankruptcy under Chapter 13, which also offers a reorganization plan that may allow the farmer to stay in business.

A foreclosure of a farm occurs if an agricultural producer does not meet his stipulated loan repayment obligations. Through legal means, a lender can take control of or force the sale of the asset that the producer had pledged as collateral when the loan was made. Foreclosure almost always results in a farmer going out of business.

TYPES OF RECENT FARM FAILURES

Available data show that, on the whole, most farm failures in 1984 and 1985 were voluntary liquidations. Other producers who went out of business did so (in descending order of rate of occurrence) through forced liquidations, foreclosure action by lenders, and decisions to file for bankruptcy. Comparison of available (but limited) data from the Farm Credit System and the Farmers Home Administration for 1984 shows that the numbers of foreclosures and bankruptcies were slightly lower than in 1983 (see table 2).

BORROWERS AT COMMERCIAL BANKS

Bankers polled in the American Bankers Association annual survey on agricultural credit (released November 1985) estimated that 4.8 percent of agricultural producers in their banking areas went out of business in the past year, up from 3.6 percent in the June 1983-June 1984 period. In both 1981-1982 and 1982-1983, the rate of failure was about 2 percent. According to the recent survey, of the 4.8 percent going out of business for all reasons, about 3.4 percent did so for financial reasons. Normal attrition and other reasons accounted for 1.4 percent. Of the 3.4 percent that went out of business for financial reasons, 2.2 percent were estimated to be voluntary liquidations, and the balance (1.2 percent) was through legal foreclosure.[1] Somewhat higher levels of foreclosures occurred in the Southern and Corn Belt States, but the highest rate of voluntary liquidations occurred in the West.

Farm credit condition reports from Federal Reserve Districts surveying commercial bankers for such data show that, from October 1984 to March 1985, the percentage of farmers going out of business ranged from 2 to 5 1/2 times the normal rate during these fall and winter months (see table 3 for Federal Reserve District data).[2] The District reporting the highest rate--6.5 percent--Kansas City; the lowest rate--1.0 percent--was reported by the Dallas District. Those who went out of business due to foreclosure ranged from .2 percent in the Dallas Federal Reserve District to 2.1 percent in the Atlanta District.

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[1] American Bankers Association. ABA Bankers News Weekly, v. 4, no. 46, November 12, 1985. p. 7.

More recent (April-September 1985) data from the Minneapolis and Kansas City Federal Reserve Bank districts indicate no major change in the farm failure rate. Kansas City District bankers reported that 3.1 percent of farmers and ranchers in the district went out of business for financial reasons in the last 6 months--three times the perceived normal rate. The median (not the average) response of Minneapolis district bankers indicates that the percentage of district farmers going out of business increased from 2 percent in April-September 1984 to 2.8 percent in April-September 1985. The average response shows a jump from 2.8 percent in the second and third quarters of 1984 to 4.7 percent in the same period of 1985.

Although a comparison of these results with those obtained in an October-March survey from the previous year indicates a continuation and apparent increase in the failure rate, it is important to remember that this increase is up from a rate that traditionally has been very low. In addition, Federal Reserve District surveys represent only bankers' perceptions of the normal and current rates of farm failures in their lending areas and do not attempt to quantify the actual number of producers who went out of business.

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[2] The rate of farm failures normally increases in the first months of the calendar year. Most loan payments fall due between January and March, and farmers must apply for short-term operating loans for the next planting season. The resulting assessment of a borrower's economic viability by the lender may result in the decision not to extend more credit, which may in turn result in a farmer's decision to go out of business. Farm sector stress is now causing lenders to make viability assessments shortly after harvest in the fall, according to the American Bankers Association.

BORROWERS AT FARM CREDIT SYSTEM LENDING INSTITUTIONS

Current and definitive data on the total number of Farm Credit System (FCS) borrowers who have gone out of business is not available. The FCS in 1982 began collecting data on the number of foreclosures that its borrowers experienced, but discontinued aggregating such data after September 1984. FCS lenders in the January-September period of 1984 initiated 2,908 foreclosure actions against their borrowers. Since the figures are incomplete, it is difficult to judge whether 1984 as a whole would have represented an increase over or decrease from the 1983 foreclosure figure of 3,431. However, the 1984 number, although incomplete, does represent almost a doubling of the 1982 figure of 2,442 (see table 2).

Not all foreclosure actions initiated by FCS lenders are necessarily carried through to a forced liquidation, which frequently takes the form of an auction. In most cases, borrowers bring their account current or refinance their loans. Some cases result in partial or complete liquidations; only a smaller portion of cases involving the initiation of foreclosure action result in a farmer going out of business.

BORROWERS AT THE FARMERS HOME ADMINISTRATION

The number of FmHA farm borrowers who went out of business in fiscal years 1984 and 1985 continued to decline from the 1982 peak of 8,227. Declines have occurred in all categories of financial reasons (see table 4).

FmHA data show that for fiscal year 1985, 4,695 (compared to 6,713 in FY84) FmHA borrowers went out of business. This represents 1.6 percent (FY84--2.4 percent) of all active borrowers. Involuntary, or forced liquidations totaled 1,833 (FY84--2,187); voluntary conveyances--1,090 (FY84--1,409); bankruptcy discharges--811 (FY84--1,124); foreclosures--792 (FY84--1,422);[3] and transfers and assumptions--169 (FY84--571).[4]

The decline in farm failures among FmHA borrowers is due in part to actions taken in FY85 in response to public and congressional concern about the severity of agricultural finance problems in fall 1984. Under FmHA's two major programs in FY85, direct loans and loan guarantees almost doubled from FY84's $2.8 billion to FY85's $5.4 billion. Furthermore, FmHA initiated a debt-set-aside program and used other, already existing mechanisms for making loan repayment easier to help nearly 45,000 of its borrowers remain in business. The debt set-aside program expired on September 30, 1985.

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[3] This figure includes foreclosures completed by lienholders on other loans to FmHA borrowers as well as those completed by FmHA.

[4] Voluntary conveyances, and transfers and assumptions, are two terms found only in FmHA's categories of reasons for borrowers going out of business. A voluntary conveyance occurs when a farmer transfers his or her security property to FmHA to satisfy loan obligations. A transfer and assumption occurs when a farmer transfers security property to another FmHA borrower or FmHA-eligible borrower and that person assumes responsibility for the outstanding loan and FmHA terms.

A second program, the debt adjustment program (DAP), allowed FmHA to guarantee loans of borrowers at commercial banks and Farm Credit System banks. A guarantee would provide backing for the restructuring of a loan if the commercial bank or FCS institutions would write down 10 percent of the unpaid principal and/or reduce the interest on a loan to a level that would result in a break-even cash flow. This helped commercial banks and FCS lenders to avoid having to foreclose on certain of their most vulnerable borrowers. During FY85, FmHA approved 426 DAP guarantees (59 percent of those applications received) totaling $61 million. The DAP program will continue in FY86.

The Farmers Home Administration has also had a self-imposed freeze on foreclosure proceedings since the beginning of 1984, in response to a November 1983 court ruling that affected the agency's supervision of delinquent borrowers. The number of foreclosures completed by FmHA (as opposed to foreclosures completed by lienholders on other loans to FmHA borrowers) declined from 615 in 1983 to 356 in 1984, and to 89 in FY85, as a result of the foreclosure moratorium.

CURRENT OUTLOOK

Economic analysts are not predicting any substantial improvement in farm income in the immediate future, especially among dairy, cash grain, and livestock farmers in the Northern Plains, Lake States, and Corn Belt--the type and location of farms currently experiencing the greatest financial stress. Furthermore, the effect of any congressionally mandated deficit reduction on interest rates and the availability of Federal Government loans and loan guarantees is difficult to predict over the next 2 years. Another unknown factor is the steps that the Farm Credit System will take to shore up its weaker member institutions and restore economic viability, and the effect those steps will have on its financially vulnerable borrowers.

A recent report on a January 1985 USDA survey gives the following assessment of financially vulnerable farmers nationwide:

> . . . a third of all farms with annual sales over $40,000 face financial difficulties. About 20 percent show a high debt load and negative cash flow, while an additional 10 percent are considered potentially at risk because of high debt loads, even though they had positive cash flow last year.[5]

According to USDA, "This development is especially critical because commercial farms [those with sales between $40,000 and $500,000], although only 34 percent of all farms, account for 90 percent of all farm sales."[6]

Some observers think it can no longer be said that those farmers going out of business are primarily those who were poor managers or who failed to adapt to changing economic trends in agriculture. Low commodity prices and a continuing decline in farmland values are negatively affecting the viability of operations that have lower than a 40 percent debt-to-asset ratio, but that have a negative cash flow.

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[5] U.S. Department of Agriculture. Economic Research Service. Financial Characteristics of U.S. Farms, January 1985. Agriculture Information Bulletin Number 495. Washington, July 1985. p. vi.

[6] Ibid.

The vulnerability of farmers at higher debt-to-asset ratios is even greater. Eleven percent of all commercial farmers are currently classified as technically insolvent (their debt is larger than the value of the assets they own); 12 percent are classified as very highly leveraged (debt-to-asset ratios between 70 and 100 percent); and 22 percent are classified as highly leveraged (debt-to-asset ratios between 40 and 70 percent). Given the flat projections for farm income, it is highly likely that producers in these three categories will continue to go out of business at a higher than normal rate.

The American Bankers Association data on the number of farm borrowers expected to be denied credit also suggests continuation of higher than normal rates of farm failure for 1986. Surveyed bankers estimated that by mid-1986, 5.7 percent of their customers will be discontinued--about twice the rate in 1983.

CONCLUSION

Whether the large number of financially vulnerable farmers translates into a continuation of a higher than normal rate and number of farmers going out of business may depend as much on lenders' forbearance policies as on U.S. farm and broader economic policies. Congressional debate in the upcoming months may focus on reconciling the activities of the newly created Farm Credit System Capital Corporation in handling the worst loans held by FCS lenders with a perceived social need to help as many farmers as possible to stay in farming. New FmHA regulations (as of November 1, 1985) that set more rigid guidelines than in the past for calling in delinquent loans and proceeding with foreclosure are likely also to be a point of controversy. Furthermore, deficit-reduction measures are likely to have an impact on FmHA's ability to provide credit in response to an anticipated increase in applications from discontinued borrowers of FCS and commercial banks.

At the same time, it is important to remember that although the rate and number of producers who have gone out of business in the last few years is higher than normal, media accounts of foreclosures in the Midwest (where the problem is comparatively greater) should not be construed to mean that farm failure is rampant on a national scale. Roughly two-thirds of U.S. farmers are either doing well or at least managing to survive. Most farmers who go out of business do so through voluntary liquidation, and they reflect a trend of decreasing farm numbers that has been continuing since 1935. Public policies that would begin to improve farm income and help borrowers to reduce their level of indebtedness might allow farm failures to decline to a more historically normal rate and level. In the meantime, programs to assist displaced farmers handle the stress of farm failure and to retrain them for other jobs will probably receive increasing public and political attention.

TABLE 1. FARM NUMBERS AND LAND IN FARMS

The number of farms in the United States in 1985 is estimated at 2.29 million, down 2 percent from the 2.33 million in 1984, and down 6 percent from the 2.43 million in 1980. The number of farms declined during the 1970s, showed a slight increase in 1980 and 1981, then declined between 1 and 2 percent per year from 1982 to 1985.

Total land in farms for 1985 is 1,016 million acres, down fractionally from a year earlier and down 2.2 percent from 1980. Land in farms has declined every year since reaching its peak at 1,206 million acres in 1954.

Since the number of farms declined at a faster rate than land in farms, the average size of farms increased from 427 acres in 1980 to 445 acres in 1985.

The proportion of large and medium sized farms declined while that of small farms (annual sales of less than $10,000) was up. However, the small farms still only account for 12 percent of total land in farms. In contrast, the large farms (annual sales of $100,000 or more) account for about half of the total farm land. The average size of small and medium farms increased in 1985 while the average size of large farms was down from 1984.

NUMBER OF FARMS AND LAND IN FARMS, UNITED STATES, JUNE 1, 1980-85

Year	Number of Farms	Land in Farms	Average Size of Farms
	Thousands	Thousand Acres	Acres
1980	2,433	1,038,885	427
1981	2,434	1,034,190	425
1982	2,401	1,027,795	428
1983	2,370	1,024,195	432
1984	2,328	1,019,378	438
1985 1/	2,285	1,015,583	445

1/ Preliminary.

PERCENT OF FARMS, LAND IN FARMS, AND AVERAGE SIZE, BY ECONOMIC CLASS, UNITED STATES, JUNE 1, 1984-85

Economic Class Gross Value of Sales	Percent of Total				Average Size of Farms	
	Farms		Land			
	1984	1985	1984	1985	1984	1985
	Percent				Acres	
$ 1,000-$ 9,999	50.5	51.2	11.3	12.1	98	105
$ 10,000-$99,999	35.6	35.0	39.1	40.7	481	517
$100,000+	13.9	13.8	49.6	47.2	1,562	1,520
TOTAL	100.0	100.0	100.0	100.0	438	445

Source: U.S. Dept. of Agriculture. Statistical Reporting Service. Crop Reporting Board. Crop Production. August 1985.

TABLE 2. Agricultural Producers Who Have Discontinued Farming, By Type of Action: Calendar Years 1982 - 1984, January - September 1985

	1982	1983	1984	1985
Foreclosures				
Farmers Home Administration	860 a/	1,516 b/	1,222 b/	619 b/
Farm Credit System c/ d/	2,442 e/	3,431	2,908 f/	N/A
Total	3,302	4,947	4,130	619
Bankruptcy Discharges Ordered				
Farmers Home Administration	1,345 a/	1,326	1,062	631
Voluntary Liquidations or Sales				
Farmers Home Administration	3,717 a/ g/	2,771	1,939	1,509
Other				
Farmers Home Administration h/	1,444 a/	2,244	1,771	1,009
TOTAL WHO WENT OUT OF BUSINESS	9,808	11,288	8,902	3,768

N/A - Not Available

NOTE: This table is based on available data from the Farmers Home Administration (FmHA) and the Farm Credit System (FCS). As of January 1, 1985, FmHA accounted for 12 percent of farm debt outstanding; the FCS accounted for 32 percent. Consistent data on foreclosures is not available from FCS lenders for late 1984 and all of 1985; data on FCS borrowers going out of business by other types of action are not available. Comparable data from commercial banks, life insurance companies and other agricultural lenders are not available.

a/ Only March to December 1982 data available for FmHA.
b/ Includes foreclosure actions completed by prior or junior lienholders.
c/ Production Credit Associations and Federal Land Banks.
d/ Only foreclosure actions carried to auction by court order.
e/ Does not include data from all 12 Farm Credit Districts.
f/ January to September 1984 only.
g/ Includes some foreclosures completed by other lenders as prior or junior lienholders.
h/ Includes other voluntary liquidations, transfers and assumptions, and voluntary conveyances.

Source: U.S. Dept. of Agriculture. FmHA Farm and Housing Activity Report, September 30, 1985, and previous years. Also, Farm Credit Administration.

TABLE 3. FIFTH FEDERAL RESERVE DISTRICT—RICHMOND 1/2/
District Farmers Going Out of Business or Partially Liquidating Assets 1982-1985 3/

Percentage of Farmers Who	Normally During April-Sept. 4/	April-Sept. 1985	April-Sept. 1984
		(percent)	
Went Out of Business for			
Reasons of Financial Stress	.3	N/A	.4
Bankruptcy Proceedings	.1		.1
Foreclosure	.1		.1
Other Financial Reasons	.1		.2
Reasons Unrelated to Financial Stress	.2		.2
All Reasons	.5		.6
Partially Liquidated	.4		1.0

Percentage of Farmers Who	Normally During Oct.-March 5/	Oct. '84-March 1985	Oct. '83-March 1984	Oct. '82-March 1983
Went Out of Business for				
Reasons of Financial Stress	.6	3.3	.5	1.5
Bankruptcy Proceedings	.1	.7	.1	.4
Foreclosure	.2	1.6	.1	.3
Other Financial Reasons	.3	1.0	.3	.8
Reasons Unrelated to Financial Stress	.3	.8	.2	.4
All Reasons	.9	4.1	.7	1.8
Partially Liquidated	.7	2.9	1.1	2.4

1/ Data in these tables represent surveyed bankers' perceptions of normal and current rates of farm failures in their lending areas. They are useful only for detecting trends within each district, and should not be used for comparing conditions among districts or computing actual numbers of farmers going out of business.

2/ The Fifth Federal Reserve District includes South Carolina, North Carolina, Virginia, Maryland, the District of Columbia and West Virginia.

3/ Averages of late March and late September reports by rural bankers on the farmers in their trading areas.

4/ Acc. to 1st Quarter 1983 survey.

5/ Acc. to 3rd Quarter 1984 survey.

N/A = Not Available

NOTE: Totals may not add due to rounding.

Source: Quarterly Agricultural Credit Conditions Surveys of the Richmond, Atlanta, Minneapolis, Kansas City, and Dallas Federal Reserve Districts, and telephone interviews.

TABLE 3 (cont'd). SIXTH FEDERAL RESERVE DISTRICT—ATLANTA 1/
District Farmers Going Out of Business or
Partially Liquidating Assets 1982-1985 2/

Percentage of Farmers Who	April-Sept. 1985	April-Sept. 1984	April-Sept. 1983	April-Sept. 1982
		(percent)		
Went Out of Business for				
Bankruptcy Proceedings	N/A	N/A	.8	1.2
Foreclosure			.6	1.8
Forced Liquidation			.4	2.2
Reasons Unrelated to Financial Stress			1.2	1.7
Partially Liquidated			3.9	5.2

Percentage Farmers Who	Oct.-March 1985	Oct. '83-March 1984	Oct. '82-March 1983
Went Out of Business for			
Bankruptcy Proceedings	2.1	.9	2.0
Foreclosure	2.1	1.6	1.7
Forced Liquidation	2.4	1.0	3.1
Reasons Unrelated to Financial Stress	2.9	1.8	2.4
Partially Liquidated	8.2	7.7	8.9

1/ The Sixth Federal Reserve District includes Georgia, Florida, Alabama, and parts of Mississippi, Tennessee, and Louisiana.

2/ Averages of late March and late September reports by rural bankers on the farmers in their trading areas.

N/A = Not Available

NOTE: Totals may not add due to rounding.

TABLE 3 (cont'd). NINTH FEDERAL RESERVE DISTRICT—MINNEAPOLIS 1/
District Farmers Going Out of Business or
Partially Liquidating Assets 1982-1985 2/

Percentage of Farmers Who	Normally During April-Sept.	April-Sept. 1985	April-Sept. 1984	April-Sept. 1983	Sept. 1982
Went Out of Business for					
Reasons of Financial Stress	.8	4.7	2.8	1.7	N/A
Bankruptcy Proceedings	.2	1.4	.7	.4	.7
Foreclosure	.3	1.6	1.1	.6	.8
Other Financial Reasons	.3	1.8	1.0	.7	.4
Reasons Unrelated to Financial Stress	.9	2.4	1.2	1.0	N/A
All Reasons	1.7	7.1	4.0	2.7	4.3
Partially Liquidated	1.3	6.9	4.6	3.4	3.6

Percentage of Farmers Who	Normally During Oct March	Oct. '84-March 1985	Oct. '83-March 1984	Oct. '82-March 1983
Went Out of Business for				
Reasons of Financial Stress	.9	3.2	3.4	2.0
Bankruptcy Proceedings	.2	.7	.7	.5
Foreclosure	.4	1.1	1.4	.8
Other Financial Reasons	.3	1.4	1.3	.7
Reasons Unrelated to Financial Stress	.7	.9	1.1	.8
All Reasons	1.6	4.1	4.5	2.7
Partially Liquidated	1.3	4.2	4.6	3.6

1/ The Ninth Federal Reserve District includes Montana, North Dakota, South Dakota, Minnesota, upper Wisconsin, and Michigan's Upper Peninsula.

2/ Averages of late March and late September reports by rural bankers on the farmers in their trading areas.

N/A = Not Available

NOTE: Totals may not add due to rounding.

TABLE 3 (cont'd). TENTH FEDERAL RESERVE DISTRICT—KANSAS CITY 1/
District Farmers Going Out of Business or
Partially Liquidating Assets 1982-1985 2/

Percentage of Farmers Who	April-Sept. 1985	Normally	April-Sept. 1984	Normally	April-Sept. 1983	Normally
			(percent)			
Went Out of Business for Reasons of Financial Stress	3.1	1.6	4.5	1.6	2.6	.9
Reasons Unrelated to Financial Stress	.7	.7	1.3	1.1	1.8	1.6
All Reasons	3.8	2.3	5.8	2.7	4.4	2.5

Percentage of Farmers Who	Oct. '84-March 1985	Normally	Oct. '83-March 1984	Normally	Oct. '82-March 1983	Normally
Went Out of Business for Reasons of Financial Stress	6.5	1.7	4.2	1.6	2.9	1.2
Reasons Unrelated to Financial Stress	1.3	1.1	1.7	1.5	1.7	1.6
All Reasons	7.8	2.8	5.9	3.1	4.6	2.8

1/ The Tenth Federal Reserve District includes Kansas, Oklahoma, Nebraska, Colorado, Wyoming, the northern third of New Mexico and the western half of Missouri.

2/ Averages of late March and late September reports by rural bankers on the farmers in their trading areas.

NOTE: Totals may not add due to rounding.

TABLE 3 (cont'd). ELEVENTH FEDERAL RESERVE DISTRICT—DALLAS 1/
District Farmers Going Out of Business or
Partially Liquidating Assets 1982-1985 2/

Percentage of Farmers Who	Normally During April- 3/ Sept.	July-Dec. 1985	July-Dec. 1984	July-Dec. 1983	July-Dec. 1982
			(percent)		
Went Out of Business for Reasons of Financial Stress					
Bankruptcy Proceedings	.1	N/A	.3	.2	.5
Foreclosure	.1		.3	.3	.7
Other Financial Reasons	.3		.6	.6	1.0
Reasons Unrelated to Financial Stress	.4		.4	.7	1.0
All Reasons	1.0		1.6	1.8	3.2
Partially Liquidated	1.0		2.7	2.9	6.6

Percentage of Farmers Who	Normally During Jan.- June 4/	Jan.-June 1985	Jan.-June 1984	Jan.-June 1983
Went out of business for Reasons of Financial Stress				
Bankruptcy Proceedings	.1	.2	.2	.3
Foreclosure	.1	.6	.1	.2
Other Financial Reasons	.3	.6	.3	.7
Reasons Unrelated to Financial Stress	.5	.5	.5	.6
All Reasons	1.0	1.6	1.0	1.8
Partially Liquidated	1.5	4.2	2.2	4.0

1/ The Eleventh Federal Reserve District includes roughly the southern two-thirds of New Mexico, all of Texas, and the northern half of Louisiana.

2/ Averages of late March and late September reports by rural bankers on the farmers in their trading areas.

3/ 4th quarter 1984 response only.

4/ 2nd quarter 1985 response only.

N/A = Not Available

TABLE 4. Farmers Home Administration (FmHA) Farm Borrowers Nationwide Who Have Discontinued Farming, By Type of Action: Fiscal Years 1982-1985

	FY82	FY83	FY84	FY85
Foreclosures a/	844 b/	1,357	1,422	792
Bankruptcy Discharges Ordered	1,245	1,392	1,124	811
Voluntary Liquidations or Sales	5,908 c/	2,667	2,187	1,833
Voluntary Conveyances	-----	1,486	1,409	1,090
Transfers and Assumptions	230	627	571	169
TOTAL	8,227	7,529	6,713	4,695
Percent of FmHA Borrowers Who Went Out of Business	3.0%	2.7%	2.4%	1.6%

a/ For FYs 83-85, includes foreclosures completed by prior or junior lienholders.

b/ Some foreclosures included under voluntary liquidations. Consequently, FY82 number of foreclosures is not strictly comparable to FY83 - FY85 data.

c/ Number not strictly comparable to FY83 - FY85 data. FY82 data include some bankruptcy discharges, some transfers and assumptions, some foreclosures completed by other lenders as prior or junior lienholders, voluntary conveyances, and farm sales not involving foreclosure action.

Source: FmHA. Farmer Program Status Report, September 30, 1982; Farm and Housing Activity Report, September 30, 1983; September 30, 1984; and September 30, 1985.

OLYMPIA J. SNOWE
TESTIMONY: FmHA COLEMAN REGULATIONS
SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT
FEBRUARY 6, 1986

Mr. Chairman, I am gratified that the subcommittee has scheduled this hearing to examine a number of issues concerning the policies of the Farmers Home Administration (FmHA). I am very concerned about the confusion created over the past several months as a result of new foreclosure warnings to our Nation's farmers.

Farmers in my district in the State of Maine were alarmed to read in early-January, a large number of them for the first time, that many would receive a letter from the FmHA, representing a first step on a quick one-way trip, no questions asked, all expenses unpaid journey to the land of foreclosure, otherwise called a "Notice of Intent To Take Adverse Action."

I can only begin to describe the concern about this resurrection of the Coleman regulations among the men and women of Maine's farming community. First, we had the local articles announcing the Department's plans to send letters to every FmHA-borrowing farmer who owed more than $100 in back payments as of December 31, 1985.

In response to these articles, Maine farmers turned in every direction, including my office and the State FmHA Director's office. Given how serious the implications are for thousands of farmers across the country, imagine my surprise when I learned of the comments of the State FmHA office, such as one official's comments that "everybody's been asking us questions, and we haven't been able to tell them anything." Now, apparently, the Department of Agriculture is again feverishly at work on this issue, and no one seems to know what's going to happen next: no one has the new regulations, or the new forms... or are they the old forms?

As we rightfully respond to the challenge of fairly and compassionately helping America's farmers through one of the toughest periods in their history, it seems to me that the FmHA has acted without sensitivity in initiating these new regulations to call farmers into their County Supervisors' offices everywhere.

Apparently, the FmHA now plans to respond in different ways to different borrowers. Those farmers who have misused and violated the terms of their loans will receive one form of notice of intent to take adverse action. Farmers who are more than three years late in loan payments will receive a list of options and a letter explaining the situation, which also asks them to meet with their County Supervisor within 30 days to develop a plan. Farmers behind in payments but for less than three years will receive a letter which apparently does not give any impression of FmHA's intention to foreclose, but only asks that meetings be arranged with County Supervisors to examine their individual situations, and see what kind of financial structuring would be constructive.

I have more reason to be encouraged at the moment about this new approach being taken with respect to the letters. The FmHA is -- and always should be -- in the business of trying to be helpful to farmers, as would appear to be the case with this new direction being taken. I am concerned, however, that the recent indecisiveness and confusion emanating from the FmHA could easily be repeated. I believe this Subcommittee must act to ensure such episodes are not repeated.

Maine is facing the serious challenge of helping the potato industry through a very difficult period of transition. The industry is adjusting painfully to tough market conditions. These farmers are receiving less than $2 per 100 pounds of potatoes which cost them over $8 to produce. The potato industry may lose $100 million this year, and 25-30 percent of the farmers may face foreclosure. Nonetheless, while the outlook for the 1985-1986 season is not good for this industry, I have every reason to believe the state and the industry can rise to the challenge to put potato farming squarely back on its feet.

The FmHA cannot compound the industry's problems by pulling the rug out from under our farmers. As the FmHA shifts its financial role to loan guarantees and away from direct financing, it will be imperative that Maine gets cooperation to complete the transition. Our state has an unusually high reliance on the FmHA: approximately 2,200 out of 10,000 of our farmers are serviced by FmHA. A swift move toward guaranteed loans without any other efforts made to coordinate these actions with local banks and the

Production Credit Association would be disastrous for Maine farmers, especially in Aroostook County.

I hope that the Coleman regulations and the farmers' loan responsibilities will be clarified and, once this is done, will operate smoothly with close coordination among Supervisors, State Directors, and Washington. I also hope that during the weeks ahead, a greater appreciation of each state's individual situation -- with respect to the Coleman regulations and and new FmHA lending policies -- will be given. That would seem to be the bare minimum that this agency can do to assist the Nation's farmers, as they have done in the past.

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